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No. [illegible]

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1995

BARBARA SMILEY,
Petitioner,
v.
CITIBANK (SOUTH DAKOTA), N.A.,
Respondent.

On a Writ of Certiorari to the
California Supreme Court

BRIEF FOR THE RESPONDENT

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QUESTION PRESENTED

Of the three questions listed by petitioner, the only one actually presented in this case is the third, which respondent would suggest rephrasing as follows:

> Does the term "interest" in section 85 of the National Bank Act, 12 U.S.C. § 85, include charges by a national bank for the failure of a borrower to make timely payment of amounts due on credit card accounts?

Petitioner's first two questions are not presented. The California Supreme Court did not hold, and no party contends, that the South Dakota legislature has the power to define the term "interest" as used in section 85 of the National Bank Act. *See* discussion *infra* p. 14 n.5.

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The opinion of the California Supreme Court is reported as *Smiley v. Citibank (South Dakota), N.A.*, 900 P.2d 690 (1995) (Petitioner Appendix ("P.A.") 1-72). The opinion of the Court of Appeal appears at *Smiley v. Citibank (South Dakota), N.A.*, 26 Cal. App. 4th 1767, 1770, 32 Cal. Rptr. 2d 562, 564, *review granted*, 883 P.2d 387 (Cal. 1994) (P.A. 74-98). The order and opinion of the trial court (P.A. 99-105) are not reported.

JURISDICTION

The California Supreme Court entered its judgment on September 1, 1995. The petition was filed and docketed on November 30, 1995, and this Court granted review on January 19, 1996. This Court has jurisdiction under 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The constitutional and statutory provisions involved in this case are the Supremacy Clause, U.S. Const. Art. VI, cl. 2; section 85 of the National Bank Act, 12 U.S.C. § 85; section 86 of the National Bank Act, 12 U.S.C. § 86; section 54-3-1 of the South Dakota Codified Laws; section 54-3-1.1 of the South Dakota Codified Laws; and section 1671 of the California Civil Code. Section 85 is set forth in full in Appendix A to this brief (Respondent's Appendix ("R. App.") A). All remaining constitutional and statutory provisions are set out, in relevant part, in Appendix A to the Brief for Petitioner ("Br. App. A").

STATEMENT

The question in this case is whether the term "interest" in section 85 of the National Bank Act, 12 U.S.C. § 85, covers flat-rate late-payment charges such as those specified in two credit card agreements between petitioner and respondent.[1]

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[1] In addition to the California Supreme Court, two other state supreme courts and two U.S. courts of appeals have addressed the

A. Statutory Background

Section 85 of the National Bank Act, provides, in pertinent part, as follows:

> [a]ny [national banking] association may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidence of debt, interest at the rate allowed by the laws of the State, Territory, or District where the bank is located . . . .

12 U.S.C. § 85.

Citibank (South Dakota), N.A. ("Citibank") is a national bank, chartered by the Office of the Comptroller of the Currency (the "OCC") pursuant to the National

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same legal issue. All except the New Jersey Supreme Court have answered the question "yes." *See Spellman v. Meridian Bank*, No. 94-3203, 1995 WL 764548, *18 (3d Cir. Dec. 29, 1995) ("over-credit limit fees and late fees constitute interest, because they provide mechanisms to compensate the lender for the increased lending risk associated with people who incur these kinds of charges"), *as amended by* 1996 WL 20762 (3d Cir. Jan. 12, 1996), *rehearing en banc granted on banks' motion, opinion vacated* (Feb. 16, 1996); *Greenwood Trust Co. v. Massachusetts*, 971 F.2d 818, 830-31 (1st Cir. 1992) (both section 85 and section 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDA") pre-empt Massachusetts law prohibiting late charges), *cert. denied*, 113 S. Ct. 974 (1993); *Copeland v. MBNA Am. Bank*, 907 P.2d 87, 91 (Colo. 1995) (late-payment fees imposed on credit card accounts are "interest" under section 85), *pet. for cert. filed*, 64 U.S.L.W. 3469 (Dec. 28, 1995) (No. 95-1056); *Stoorman v. Greenwood Trust Co.*, 908 P.2d 133 (Colo. 1995) (affirming dismissal of plaintiff's complaint, also under Colorado law, as preempted by section 521 of DIDA), *pet. for cert. filed*, No. 95-1500; *Richardson v. Citibank (South Dakota), N.A.*, 908 P.2d 532, 533-34 (Colo. 1995) ("because Citibank is a national bank located in South Dakota, and South Dakota law permits the imposition of a late-payment fee, Citibank can charge Richardson a late payment fee despite the fact that a Colorado consumer protection law prohibited such fees"), *pet. for cert. filed*, No. 95-1493. *But see Sherman v. Citibank (South Dakota) N.A.*, 668 A.2d 1036 (N.J. 1995), *pet. for cert. filed*, 64 U.S.L.W. 3439 (Dec. 21, 1995) (No. 95-991); *Hunter v. Greenwood Trust Co.*, 668 A.2d 1067 (N.J. 1995), *pet. for cert. filed*, 64 U.S.L.W. 3439 (Dec. 18, 1995) (No. 95-963).

Bank Act (the "Act"). This 1864 Act established a banking system under direct federal-government control capable of distributing national currency and helping to finance the Union during the Civil War. *See generally* B. Hammond, *Sovereignty and an Empty Purse* 290 (1970). Section 85 of the Act regulates the interest that a national bank may charge on loans.

Section 85 authorizes a national bank, as a matter of federal right, to charge interest "on precisely the same footing [as state-regulated lenders] doing business in [its home] State by its laws." Cong. Globe, 38th Cong., 1st Sess. 2126 (1864) (remarks of Senator Sherman, the Act's principal drafter).[2] Specifically, section 85 of the Act provides that national banks may charge "interest at the rate allowed by the laws of the State, Territory, or District where the bank is located." 12 U.S.C. § 85 (originally section 30, 13 Stat. 99, 108 (1864)). If a national bank exceeds that limit, section 86 provides the borrower's exclusive remedy: forfeiture of all interest due on the debt or, if the lender has already received the excessive interest, twice the amount of interest paid by the borrower. *See* 12 U.S.C. § 86. The Court has described sections 85 and 86 of the Act as "covering[] the entire subject" of national bank "interest" charges. *Farmers' & Mechanics' Nat'l Bank v. Dearing*, 91 U.S. 29, 32 (1875).

The Court has construed the language of section 85 on four pertinent occasions; each decision was unanimous. In *Tiffany v. National Bank*, 85 U.S. (18 Wall.) 409, 413 (1873), the Court ruled that section 85 empowers

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[2] Section 85 originated in Section 30 of the 1864 Act. In 1873, the Act was amended and the portions of section 30 governing the interest allowed and the penalty for taking unlawful interest became sections 5197 and 5198, respectively, of the Revised Statutes. They were later codified as 12 U.S.C. §§ 85 and 86, respectively. The pertinent language has not changed since 1864. Language to which petitioner refers, authorizing the collection of interest measured by the discount rate at the district federal reserve bank, was added in 1933. *See* Banking Act of 1933, ch. 89, § 25, 48 Stat. 191.

a national bank to charge the same interest as the most favored state-regulated lender in its home state, even if that lender is not a bank. *See* 85 U.S. at 413. In *Daggs v. Phoenix National Bank*, 177 U.S. 549, 555 (1900), the Court held that if the national bank's home state sets no limit on interest charges, then the amount the national bank is "allowed" (and hence federally empowered) to charge is any interest agreed-to by the borrower. Four years later, in *Citizens National Bank v. Donnell*, 195 U.S. 369 (1904), the Court held that a monthly charge on overdrafts was "interest" within the meaning of section 85, rejecting as frivolous the claim that "this charge was [instead] a penalty because of a failure to pay a debt when due." *Id.* at 374. Finally, in *Marquette National Bank v. First of Omaha Service Corp.*, 439 U.S. 299, 318 n.31 (1978), the Court held that a national bank may charge, on interstate credit card loans, interest at the rate allowed by the laws of its home state, even if the borrower's home state would prohibit the charge. According to the Court, under section 85 the borrower's state's law "must, of course, give way." 439 U.S. at 318 n.31.

B. Factual Background

More than 6,000 banks and other financial institutions in the United States provide credit card services to consumers. *See SCFC ILC, Inc. v. Visa USA, Inc.*, 36 F.3d 958, 960, 967 n.11 (10th Cir. 1994), *cert. denied*, 115 S. Ct. 2600 (1995). There is "intense" competition on price, services, and other terms. *See The Profitability of Credit Card Operations of Depository Institutions*, Annual Report by the Board of Governors of the Federal Reserve System 6 (Sept. 1995) (hereinafter "FRB Report"). Credit card lending charges typically include a monthly "finance charge" on unpaid balances, as well as annual fees, late fees, and overlimit fees. All charges must be disclosed to consumers in the manner prescribed by the federal Truth-in-Lending Act. *See* Regulation Z, 12 C.F.R. §§ 226.5-226.9 (1993). As this Court has recognized, there is an interrelation between the components of a bank's "package" of charges: for example, lower monthly finance charges may be offset by higher annual fees or late fees. *See Marquette*, 439 U.S. at 302-03. Banks formulate different packages of charges to appeal to different customers. *See* FRB Report at 8-9.

Citibank is located in Sioux Falls, South Dakota, and has no branches elsewhere. From that location, Citibank issues Visa, Mastercard, and other credit cards to customers nationwide. (P.A. 2). Citibank's credit card lending agreements generally provide for both percentage "finance charges" on cash advances and certain outstanding purchase balances and "late payment charges" if a cardholder does not make a required minimum payment by a specified date. (*Id.*) Late-payment charges may take the form of either a flat fee or a percentage of the borrower's account balance. (Joint Appendix ("J.A.") 56, 74; P.A. 40 n.17).

Petitioner entered into two standard credit card agreements with Citibank (J.A. 49-82; P.A. 6 n.2, 40 n.17). Each agreement allowed her to borrow on a revolving basis but required her to make a minimum payment each month. Each agreement imposed a monthly "finance charge" on certain outstanding balances, calculated as either a specified percentage of the average daily loan balance for the month, or a flat minimum charge of 50 cents, whichever was larger. Petitioner does not challenge the finance charge.

Each agreement also imposed a "late charge," assessed if petitioner did not make her minimum payment within a specified number of days after the payment due date. Specifically, petitioner's Classic Card Agreement provided that a late charge of $15 would be applied if petitioner's minimum payment was more than 25 days overdue. (J.A. 56). Petitioner's Preferred Card Agreement provided that a late charge of $6 would be applied if petitioner's minimum payment was more than 15 days overdue (J.A. 74); if petitioner were still delinquent at 30 days, she would be charged an additional late fee equalling the greater of $15 or 0.65% of the current

balance. This $15 or 0.65% fee would then be assessed for each succeeding month in which petitioner's minimum payment was more than 30 days overdue. (J.A. 74). These charges are allowed by South Dakota law.[3]

C. Proceedings in the California Courts

Petitioner, a California resident, brought this purported class action in Los Angeles Superior Court. She challenges Citibank's late-payment charges under California law, alleging that the late charges provided in her agreements with Citibank violated section 1671 of the California Civil Code. (P.A. 109-110, 114-18). That statute limits late charges to a "fair average compensation for a loss which would be sustained" on a borrower's default, as estimated in a study conducted by the lender. *See Garrett v. Coast & Southern Fed. Sav. & Loan Ass'n*, 511 P.2d 1197, 1202 (Cal. 1973). Petitioner seeks a trial to determine whether the charges were permissible under this California standard.[4] Petitioner does not dispute that Citibank is located only in South Dakota or that South Dakota's law allows the charges at issue without requiring the kind of study or judicial proceeding that petitioner seeks under California law.

Citibank moved for judgment on the pleadings dismissing the Complaint. Citibank argued that section 85 of the National Bank Act empowers Citibank to charge the "interest" allowed by its home state; that the term "interest" as used in section 85 includes late-payment charges; that Citibank's late-payment charges are permitted by Citibank's home state, South Dakota; and that under this Court's decision in *Marquette*, section 85 pre-empts any conflicting law of a borrower's state.

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[3] S.D. Codified Laws Ann. §§ 54-3-1, 54-3-1.1 (1990) (Br. App. A, at 3a, 4a).

[4] California legislation that became effective on January 1, 1995, now permits banks located in California to assess specified late charges on credit card accounts. *See* Cal. Fin. Code §§ 4000-4001 (Deering Supp. 1995). Citibank's late fee charges are consistent with the charges authorized by the California Legislature.

The superior court denied Citibank's motion, and Citibank filed a petition for writ of mandate in the California Court of Appeal. The Court of Appeal ordered the superior court either to grant Citibank's motion or to show cause why its decision should not be reversed. The superior court's subsequent order granting Citibank's motion was affirmed by the Court of Appeal and the California Supreme Court.

Justice Mosk's opinion for the California Supreme Court noted that "[t]he issue is not the existence of pre-emption under section 85," because this Court's decision in *Marquette* establishes that a national bank may charge "interest" permitted by the law of its home state on interstate credit card loans and that any conflicting law of the borrower's state "must, of course, give way to the federal statute." 439 U.S. at 318 n.31. (P.A. 12-13).

The court then held that, as a matter of federal law, the term "interest" in section 85 "could include . . . a late payment fee, payable contingently in the event of default after maturity." (P.A. 19). It supported its decision by referring to the common legal usage of the term "interest" in 1864, the purpose of the Act (which it described as ensuring that a national bank stands in the shoes of the "most favored lender" within its home state), and the interpretation of the term "interest" in section 85 by the OCC, the federal agency charged with supervising the activities of national banks. (P.A. 18-25, 27-30). Accordingly, the court held that section 85 empowers a national bank to collect such charges as "interest" under federal law if other lenders located in the bank's home state are allowed to collect such charges, and that any contrary law of California is pre-empted. (P.A. 38-39). Two justices dissented, essentially on the ground that the "plain meaning" of "interest" encompasses only periodic percentage charges.

SUMMARY OF ARGUMENT

This case presents a single question of statutory construction: whether the word "interest" in 12 U.S.C. § 85 covers late-payment charges of the kind set forth in petitioner's credit card agreements with Citibank. This question is very important to national banks, their customers, and the nation's economy, but it does not implicate the broad issues of pre-emption theory or "federalism" to which petitioner devotes much of her brief.

An examination of the language, historical purpose, and consistent administrative construction of section 85 compels the conclusion that "interest" covers flat charges for the late payment of loans, such as those charged by Citibank in this case.

The Ordinary Legal Meaning. The ordinary legal meaning of "interest" in 1864 included all agreed charges for the use or detention of borrowed money. This Court contemporaneously described "interest" as the "compensation allowed by law, or fixed by the parties, for the use or forbearance of money, or as damages for its detention." *Brown v. Hiatts,* 82 U.S. (15 Wall.) 177, 185 (1872). No narrower legal definition of "interest" was or is established as a matter of usage, and none would be workable in the context of state regulation of the price of credit.

Legislatures, courts, and dictionaries, in the nineteenth century as well as today, commonly applied the term "interest" to a wide range of charges for borrowed money. These included both charges assessed before maturity and new or increased charges triggered by the failure to pay a loan on time. They also included charges stated in flat-rate as well as percentage terms. For centuries, courts have held that a flat charge for the use or detention of money is "interest" and must be counted against a state ceiling on "interest," even if the ceiling itself is stated in percentage terms. Were it otherwise, state limitations on "interest" could be evaded with impunity.

Congress' use of the word "rate" in the phrase "interest at the rate allowed in the laws of the State" does not (as petitioner suggests) imply that Congress meant to limit the statute to percentage rates. First, in 1864, as now, the word "rate" referred to both flat amounts and percentages. Noah Webster, in 1828, defined "rate" as: "Price or amount stated or fixed on anything." Second, state courts routinely applied statutes governing the "rate" of interest to flat charges. There is no reason to believe that Congress used "rate" in a narrower sense than the dictionaries, legislatures, and courts of its time.

Petitioner argues that Citibank's late charges are too high, or, as she puts it, more than "compensatory," and that they are therefore not "interest" but "penalties." But petitioner's contention that in this context "interest" and "penalties" are distinct categories is simply wrong: this Court in *Donnell* rejected the argument that charges are not "interest" because they can be labeled "penalties." And while state courts have disagreed as to whether and in what circumstances late-payment charges should be disallowed as "penalties," the courts have agreed with *Donnell* that "penalty" charges are "interest."

The argument that only "compensatory" charges are "interest" in section 85 also ignores Congress' intent that the law of South Dakota, not that of California, determines whether Citibank's package of charges, or any of them individually, is an appropriate amount. In *Daggs, supra,* the Court held that a national bank, located in a state that allows state-regulated lenders to charge (with a borrower's agreement) *any* amount of interest, has a federal right to do the same. Petitioner's attempt to reverse section 85, by reading into the statute an *a priori* "compensatory" test, and declaring that a charge that fails her test can be regulated by California, fits neither the law nor the practicalities. National banks that make credit card loans have many different kinds of lending costs. A bank might seek to recover all its costs by charging a single percentage rate, but many lenders have

found that more complex packages fit the needs of their borrowers. For example, a borrower might choose to agree to a contingent late charge to obtain a lower monthly percentage charge. Credit card lenders develop these charge packages under conditions of intense competition, and their individual component charges are economically intertwined. There is no *a priori* litmus test, applicable in advance of the selection of the appropriate state law, for determining whether a particular charge is "compensatory."

Different states may regulate the packages of interest charges assessed by their lenders in different ways: some states may set elaborate legislated boundaries; other states might undertake to consider on a case-by-case basis whether a particular package, or a particular component of that package, is "compensatory"; and still other states, like South Dakota, may decide that competition is a sufficient regulator of the price of credit. But under section 85, the key point is that the question whether a particular charge for the use, detention, or forbearance of money should be disallowed as "non-compensatory" or for any other reason is to be answered by the law of the state in which the national bank is located.

Historical Purpose. Section 85 was passed in the midst of the Civil War and was designed to protect national banks against the "hazard" of "unfriendly state legislation," *Tiffany*, 85 U.S. at 412, by giving them the interest-charging rights of the "most favored lenders" in their home states. The history of intense state hostility to nationally chartered banks was well known to Congress. If section 85 is to achieve its purpose of securing the equal footing of national banks as against state-regulated lenders, "interest" must include all charges "for the use or forbearance of money, or as damages for its detention." *Hiatts*, 82 U.S. at 185, and not some narrower category of charges.

This is easy to illustrate, as various authorities have noted. If, for example, a home state imposed a low interest ceiling on all lenders, but permitted a few favored lenders (for example, credit unions) to collect late charges, and the term "interest" in section 85 was not interpreted to empower national banks to collect such late charges, national banks would be denied the "most favored lender" status that section 85 promised them.

The OCC's Interpretation. This Court has repeatedly said that when a term in a federal statute is ambiguous, and the agency responsible for overseeing the operation of the statute has defined the term in a reasonable manner, the agency's definition is entitled to controlling weight. The OCC is responsible for overseeing the banking activities of national banks, including their compliance with section 85, and this Court has repeatedly deferred to OCC interpretations of provisions of the National Bank Act.

In regulations published after notice and comment, the OCC has squarely answered the question presented in this case, stating that "interest" in section 85 includes all national bank charges for borrowed money, specifically including late-payment fees. These regulations are consistent with advice given (and relied on by national banks and state authorities) for several decades. If there is any doubt about the meaning of "interest" in the statute, the OCC's reasonable interpretation should be dispositive.

The Interstate Application of Section 85. If the Court agrees with Citibank that "interest" includes late-payment charges, this case is at an end. The term "interest" in section 85 must of course have the same meaning whether the bank's borrower resides within or outside the bank's home state. The only remaining question is whether section 85 displaces any contrary state law in states (outside South Dakota) where Citibank's borrowers reside, and the Court has already answered that question in *Marquette*, a case involving interstate credit-card lending. The Court held that section 85 empowers a national bank to charge the interest allowed by the law of its home state to a borrower who resides in another state and that

any contrary restriction in the law of the borrower's state "must, of course, give way to the federal statute." 439 U.S. at 318 n.31.

Petitioner argues that the presumption against preemption requires a "crystal-clear statement" that Congress intended the word "interest" to cover late charges, because there is an invasion of California's "historic police power." Her argument misstates both the law of preemption and the historic circumstances surrounding section 85, and it flies in the face of this Court's decisions construing federal banking laws: from *Marquette* to the very recent decision in *Barnett Bank v. Nelson*, No. 94-1837 (U.S. March 26, 1996).

The "ultimate touchstone" of pre-emption analysis is the intent of Congress, and the presumption is but one tool in discerning that intent. Here, there is more than ample evidence that Congress intended to empower national banks to collect any agreed charge for the use, forbearance, or detention of money allowed by their home states, and to pre-empt the law of any other state.

Moreover, no significant historic police power of California is at stake in this case. Before 1864, borrowers were traveling to borrow money from banks located in other states, on terms governed by the laws of those states. As the Court noted in *Marquette*, credit-card borrowing (which occurs at the bank's location) merely increases the ease and speed of such travel. At no time since 1864, when the national banks were created, has the borrower's state of residence had any role in regulating an interest charge by an out-of-state national bank.

Furthermore, the contention that Congress meant to consign different portions of the lending package to regulation by different states is implausible. Petitioner admits that any percentage charge, including any default charge stated as an increased percentage, is "interest" covered by section 85 and not subject to regulation by California. (Br. 30). She thus agrees that under South Dakota law Citibank may charge any percentage amount a borrower agrees to, and therefore any total amount whatsoever, and California has no jurisdiction to complain. She also admits that California has no jurisdiction to regulate pre-default "up-front" flat-rate charges (Br. at 30), such as Citibank's flat 50-cent minimum finance charge. But she says, although California must stand aside for these charges, section 85 has reserved for California's jurisdiction a single strand of the lending fabric—a flat default charge, no matter how small the amount—so that California can judge whether that strand is fair and compensatory. She does not explain why California should assert jurisdiction over a single strand when the whole cloth is beyond its reach, or how her system would handle Citibank's Preferred Card late charge of 0.65% or $15, whichever is higher. Petitioner has offered no evidence that Congress intended section 85 to so fragment the regulation of a single lending package. In the absence of evidence that Congress intended such an illogical and inefficient result, section 85 should be construed, in accordance with its ordinary legal meaning, to include all charges for the use or detention of money, including the late fees at issue in this case.

ARGUMENT

I. THE TERM "INTEREST" AS USED IN 12 U.S.C. § 85 COVERS THE LATE-PAYMENT CHARGES AT ISSUE IN THIS CASE

Section 85 of the National Bank Act provides that national banks may charge "interest at the rate allowed by the laws of the State, Territory, or District where the bank is located." 12 U.S.C. § 85. To determine the meaning of such a provision, the Court traditionally looks first to the language and purpose of the statute. If this analysis does not resolve the question presented, but there is a permissible construction of the statute by the responsible agency, this Court will defer to that construction. *See NationsBank of N.C., N.A. v. Variable Annuity Life Ins. Co.*, 115 S. Ct. 810, 813-14 (1995); *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S.

837, 843 (1984). In this case, the language, purpose, and agency construction of section 85 of the National Bank Act all compel the conclusion, as a matter of federal law,[5] that the term "interest" includes fees imposed on credit cardholders for the detention of money past its due date.

A. The Ordinary Legal Meaning of "Interest" Includes Late-Payment Charges

Citibank's late fees are per-month charges imposed for keeping the bank's money past its due date. They are part of the package of fees charged by a lender—and agreed to by the borrower—as compensation for lending. Borrower delinquencies impose on lenders increased lending expenses, including higher loan-funding costs (the bank's cost of funds rises), higher and additional costs of administration and collection, and higher losses of principal (late payers are four to six times more likely than timely payers to default and become non-payers).[6] Late fees appropriately require delinquent borrowers to pay a

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[5] Citibank agrees with petitioner that the meaning of "interest" under section 85 is a question of federal law. Citibank has never contended otherwise. Although the state in which a national bank is located determines the amount of interest that the bank is allowed to charge, a state can neither enlarge nor shrink the federal definition of "interest." The California Supreme Court agreed with this position and devoted the bulk of its opinion to analyzing the meaning of "interest" under the appropriate methods of statutory interpretation.

Accordingly, petitioner's first two Questions Presented are not actually at issue in this case. Specifically, (1) Citibank agrees with petitioner that Congress did not intend South Dakota law to define the federal term "interest"; the California Supreme Court also agreed, stating that "Congress has made no such delegation" (P.A. 30), and (2) the question whether Congress may constitutionally delegate to the states the task of defining the term "interest" is not presented because there has been no such delegation. The role of state law here in determining the amount of interest a national bank is federally empowered to charge is neither inappropriate nor unusual. *See United States v. Sharpnack*, 355 U.S. 286, 294 (1958).

[6] *See* Robert E. Litan, *The Economics of Credit Cards*, at 8 (Jan. 1993).

higher total compensation to the bank than those who are not delinquent.

Citibank's late fees fall comfortably within the ordinary legal meaning of the term "interest." At the time of the enactment of the National Bank Act, as well as today, "interest" was commonly understood to include all charges for borrowed money, regardless of whether the charges were imposed before or after default, stated in percentage or flat form, shown to recompense the lender for any particular lender cost, or deemed "more than compensatory" or "punitive" under the law of any particular jurisdiction.

1. *"Interest" Includes All Charges for the Borrower's Use and Detention of Money Due on a Loan*

Although the term "interest" has different meanings in different contexts,[7] when the issue is the permissibility of loan charges agreed to between lender and borrower, "interest" means all charges assessed for the use or detention of money whether before or after a borrower's default. This usage accords with common sense, as well as economic sense, because the charges all form part of the economic package of fees charged for the lending of money. It also accords with the long-prevailing interpretations of section 85 by the lower courts, which have applied the statute to loan charges of all kinds.[8]

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[7] *See, e.g., Deputy v. Du Pont*, 308 U.S. 488, 498 n.11 (1940) (adopting narrow definition for purposes of tax deductibility and stating that there were "irrelevant other lines of authority . . . where 'interest' in a different context has been used to describe damages or compensation for the detention or use of money or of property"); *cf. NationsBank of N.C., N.A. v. Variable Annuity Life Ins. Co.*, 115 S. Ct. 810, 816 (1995) ("a characterization fitting in certain contexts may be unsuitable in others").

[8] *See Cades v. H&R Block, Inc.*, 43 F.3d 869, 873-74 (4th Cir. 1994) (flat service charges for tax refund anticipation loans), *cert. denied*, 115 S. Ct. 2247 (1995); *American Timber & Trading Co. v. First Nat'l Bank*, 690 F.2d 781, 787-88 (9th Cir. 1982) (charges incurred by way of compensating balance requirements); *Fisher v.*

In defining the category of "interest" that, by statute, ceased to run during the Civil War, this Court stated: "Interest is the compensation allowed by law, or fixed by the parties, for the use or forbearance of money, or as damages for its detention." *Brown v. Hiatts*, 82 U.S. (15 Wall.) 177, 185 (1872). *See also Redfield v. Ystalyfera Iron Co.*, 110 U.S. 174, 176 (1884) ("Interest is given on money demands as damages for delay in payment, being just compensation to the plaintiff for a default on the part of his debtor"); *Shoemaker v. United States*, 147 U.S. 282, 321 (1893) ("Interest accrues . . . in the nature of damages, by reason of the failure of the debtor to pay the principal when due").[9] Contrary to

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First Nat'l Bank, 548 F.2d 255 (8th Cir. 1977) (credit card cash-advance fees); *Northway Lanes v. Hackley Union Nat'l Bank & Trust Co.*, 464 F.2d 855, 862 (6th Cir. 1972) (closing costs); *Panos v. Smith*, 116 F.2d 445, 446 (6th Cir. 1940) (mortgage taxes and recording fees); *Cronkleton v. Hall*, 66 F.2d 384, 387 (8th Cir.) (bonuses or commissions), *cert. denied*, 290 U.S. 685 (1933); *Watson v. First Union Nat'l Bank*, 837 F. Supp. 146 (D.S.C. 1993) (credit card overlimit fees); *Attorney General v. Equitable Trust Co.*, 450 A.2d 1273, 1294 (Md. 1982) (returned check fees); *In re Gerber's Estate*, 9 A.2d 438, 443 (Pa. 1939) (brokerage charges); *Kenty v. Bank One, Columbus, N.A.*, No. C2-90-709, 1992 WL 170605, at 2-4 (S.D. Ohio Apr. 23, 1992) (charges for insurance on loan collateral); and, of course, the late charges at issue here (*see supra* n.1).

[9] Virtually every contemporaneous legal dictionary also included among the definitions of "interest" the payment of compensation for the use or detention of money, without any limitation as to either timing or form. For example, Timothy Cunningham stated that "[i]nterest is recovered by way of damages where damages are recovered *ratione detentionis debit*" (that is, "on account of (or by reason of) detention of a debt"). 2 Timothy Cunningham, *A New and Complete Law Dictionary* (Dublin 1764). John Bouvier defined "interest" as "[t]he compensation which is paid by the borrower of money to the lender for its use, and, generally, by a debtor to his creditor in recompense for his detention of the debt." 1 John Bouvier, *A Law Dictionary* 733 (Phila., J.B. Lippincott & Co., 14th rev. ed. 1877). *The American and English Encyclopedia of Law* noted that interest "is generally allowed by law on two grounds, namely, on contract, express or implied, or by way of damages, either for a default in the payment of a debt, or for

petitioner's lengthy argument, this Court did not adopt a narrower definition of "interest" in *United States v. Texas*, 507 U.S. 529 (1993): the Court there merely observed that the common law right of the United States to receive pre-judgment interest did not include the right to certain fees. The charges denoted by the word "interest" in a particular context obviously will not always include flat late charges.

At the time of adoption of the National Bank Act, the broad definition of "interest" reflected in *Hiatts*, *Redfield*, and *Shoemaker* was commonly understood to include not only charges for the use of money prior to default on a loan, but also new or increased charges triggered by the borrower's failure to pay on time. *See, e.g.*, *Hubbard v. Callahan*, 42 Conn. 524 (1875); *Wilkerson v. Daniels*, 1 Greene 180, 188 (Iowa 1848); cases cited at n.11, *infra*. Indeed, in 1864, the legislatures of many states and territories specifically defined "interest" to include post-default charges.[10] Courts in the same and other states

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a use or benefit derived from the money of another." 9 *The American and English Encyclopedia of Law* 380 (John Houston Merrill ed. 1890) (footnotes omitted). That source further noted that, "[w]here one has received the money of another and has not the right conscientiously to retain it, the law imposes interest as damages for the breach of an implied promise to pay it over." *Id.* at 397. And Alexander Burrill stated that "[i]nterest is an incident which the law gives the creditor, upon failure of the debtor to pay the principal." 2 Alexander M. Burrill, *A Law Dictionary and Glossary* 90 (N.Y., Baker, Voorhis & Co., Law Publishers 1870). *See also* 3 Giles Jacob, *The Law Dictionary Explaining the Rise, Progress, and Present State of the English Law* 505, 506 (T.E. Tomlins American ed. 1811) ("Interest is recovered by way of damages, where damages are recovered *ratione detentionis debiti*"); 2 Giles Jacob, *The Law Dictionary Explaining the Rise, Progress, and Present State of the English Law* (T.E. Tomlins London ed. 1809) (same).

[10] **Alabama:** prescribing interest rate to be applied "from the day such money . . . *should have been paid*," Ala. Code § 1520 (1852); **Arkansas:** allowing either agreed-upon or prescribed interest for "all moneys *after they become due*," Act of Mar. 20, 1939, ch. 92, § 1, 1858 Ark. Stat. Dig. 621; **California:** allowing either agreed-upon or prescribed interest for "all moneys *after they*

also routinely treated post-default charges as "interest."[11]

Accordingly, the historical evidence demonstrates that at the time of the enactment of the National Bank Act, "interest" was understood in the law to include additional or higher charges for the detention of money after its due date—charges that were triggered by (and thus contingent upon) the borrower's default. Many modern

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become due," Act to Regulate the Interest of Money, ch. 31, § 1, 1850 Cal. Stat. 92 (1850); **Illinois:** rate of interest applied to money loaned "or *in any manner due and owing,*" Act to Legalize Ten Per Cent. Interest When It Is Agreed upon Between Parties, § 2, 1857 Ill. Laws 45, 46 (1857); **Iowa:** allowing either agreed-upon or prescribed interest for "all moneys *after the same becomes due,*" Act to Regulate the Interest on Money, ch. 72, § 1787, 1860 Iowa Rev. 316 (1853); **Louisiana:** providing that debts bear the prescribed interest rate "*from the time they become due,*" Act to Regulate the Rates of Interest, No. 291, § 1, 1855 La. Acts 352 (1855); **Minnesota:** providing that "all agreements and contracts shall bear the same rate of interest *after they become due* as before, if the same shall be clearly expressed therein," Act Fixing the Rate of Interest, ch. 56, § 1, 1860 Minn. Laws 226 (1860); **Mississippi:** providing that "it shall be lawful for parties to contract in writing for the payment of any rate of interest not exceeding ten per cent per annum upon any debt *after the maturity thereof,*" Act to Authorize Parties to Contract in Writing for the Rate of Interest, ch. 29, § 1, 1856 Miss. Laws 92 (1856); and **Ohio:** providing that "all creditors shall be entitled to receive interest on money, *after the same shall become due,*" Act Fixing the Rate of Interest, § 1, 1824 Ohio Laws 108 (1824). The territories included **Missouri:** allowing prescribed rate of interest for "all moneys *after they become due*" and agreed-upon rate of interest on "*money due* or to become due" Act of Mar. 24, 1845, ch. 88, §§ 1, 2, 1845 Mo. Rev. Stat. 614; and **New Mexico:** allowing agreed-upon or prescribed rate of "interest" for "*money due,*" Act Relating to Money and Interest, §§ 3, 4, 1851 N.M. Laws 254 (1852). *See also* **Idaho:** allowing prescribed rate of interest for "all moneys *after they become due*" and agreed-upon rate of interest on "money due or to become due," Act in Relation to Money of Account and Interest, §§ 4, 5, 1879 Idaho Sess. Laws 7, 7-8 (1879). (All emphasis added.)

[11] *See, e.g., Miller v. Kempner*, 32 Ark. 573, 574 (1877) (parties permitted to contract for post-maturity interest under constitutional provision providing that "parties were at liberty to contract for any rate of interest they might agree upon"); *Portis v. Merrill*,

statutes and courts have applied a similar definition.[12] Indeed, petitioner appears to accept this meaning of the

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33 Ark. 416, 418 (1878) (same); *McKay's Estate v. Belknap Sav. Bank*, 59 P. 745, 747 (Colo. 1899) (post-default interest permissible under statute providing that parties "may stipulate . . . for the payment of a greater or higher rate of interest than eight per cent per annum, and any such stipulation may be enforced in any court . . . ."); *Capen v. Crowell*, 66 Me. 282, 283 (1877) (interest recoverable under note stipulating higher rate of interest after maturity, under statute providing that "in the absence of any agreement in writing, the legal rate of interest shall be six per cent per year"); *Brannon v. Hursell*, 112 Mass. 63, 71 (1873) (plaintiff entitled to recover post-default interest at rate specified in contract, under statute making it lawful to contract in writing for "any amount" of interest); *Linton v. National Life Ins. Co.*, 104 F. 584, 593 (8th Cir. 1900) (provision in promissory note for increase in rate of interest after maturity was valid and enforceable under Nebraska statute permitting parties to agree to amount of interest); *Hopkins v. Crittenden*, 10 Tex. 189, 189-90 (1853) (post-maturity charges were interest); *Cecil v. Hicks*, 70 Va. (29 Gratt.) 1 (1877) (post-default charges were interest).

[12] *Statutes:* Soldiers' and Sailors' Civil Relief Act of 1940, 50 U.S.C. App. § 526 ("'interest' includes service charges, renewal charges, fees, or any other charges"); **Del.** Code Ann. tit. 5, § 950 ("[A] bank may impose, as interest, a late or delinquency charge . . . ."); **S.D.** Codified Laws Ann. § 51-A-12-13 (defining all authorized fees, including late fees, to be "deemed interest"); **Ga.** Code Ann. § 7-4-2(a)(3) (Michie) ("[T]he term 'interest' means a charge for the use of money . . . over the term of the contract at the rate stated in the contract or computed in any other way or any other form."); **Ill.** Ann. Stat. ch. 205, sec. 675/6 (Smith-Hurd) ("[A] financial institution may, if the agreement governing the revolving credit plan so provides, charge and collect as interest, in such manner or form as the plan may provide, an annual or other periodic fee for the privileges made available to the borrower under the plan, a transaction charge or charges, late fees or delinquency charges, returned payment charges, over limit charges and fees for services rendered."); **Ohio** Rev. Code Ann. § 1107.262(A) (Baldwin) ("[A] bank may charge, collect, and receive, as interest, other fees and charges that are agreed upon by the bank and the borrower, including, but not limited to, periodic membership fees, cash advance fees, charges for exceeding a designated credit limit, charges for late payments, and charges for the return of a dishonored check."). *Courts: Gordon Fin. Co. v. Chambliss*, 236 So. 2d 533, 535 (La. Ct. App. 1970) (holding that

term, conceding, for example, that higher periodic percentage-based charges following default for the delay in repayment would properly be considered "interest" even under her theory. (Br. 30).

2. *"Interest" Includes Flat as Well as Percentage Charges*

The authorities also make clear that "interest" has always included charges for borrowed money—whether pre-maturity or post-maturity—that are stated in flat rather than percentage terms. *See, e.g., Wernwag v. Mothershead*, 3 Blackf. 401, 402 (Ind. 1834) (five dollar per week late-payment charge was permissible "*interest at the rate* specified in the note from the time it became due") (emphasis added); *Fry v. Coleman*, 1 Pa. 445, 447 (1857) (agreement to pay $100 if loan not paid within ten days after maturity was forbidden by usury law); *Craig v. Pleiss*, 26 Pa. 271, 273, 274 (1856) (flat charge of $25 was a "*rate of compensation*" within usury statute) (emphasis added); *Ferrier v. Scott's Adm'rs & Heirs*, 17 Iowa 578 (1864) (flat charge to extend a note beyond its original term); *Melville v. American Benefits Bldg. Ass'n*, 33 Barb. 103, 114 (N.Y. 1860) (aggregated total of amounts labeled monthly fees, dues, and penalties was excessive interest under usury law); *Swartwout* v. *Payne*,

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$5 delinquent charge on installment note was "interest" under state usury statute); *Swindell v. Federal Nat'l Mortgage Ass'n*, 409 S.E.2d 892, 895 (N.C. 1991) (state usury statute applies to late payment charge of five percent on overdue mortgage payments); *Douglas Elecs., Inc. v. Pinnacle Sys., Inc.*, 805 S.W.2d 852, 857 (Tex. Ct. App. 1991) (late fee of 1.5% per month on outstanding account balance was subject to usury statute); *Veytia v. Seiter*, 740 S.W.2d 64, 65 (Tex. Ct. App. 1987) ("Absent statutory language to the contrary, late charges are interest within the meaning of the usury statutes"; usury statute applies to late charges of $20 per day on mortgage payments, *aff'd*, 756 S.W.2d 903 (Tex. 1988); *see also Scarr v. Boyer*, 818 P.2d 381, 383 (Mont. 1991) increase in interest rate after default on not is subject to state usury statute).

19 Johns. 249 (N.Y. Sup. Ct. 1822) ($15 "premium" to refinance matured note was usurious).[13]

There is no principled reason why the word "interest" would exclude flat charges that are paid for the use or detention of money, and, except for contending that all flat late charges are supracompensatory "penalties" (*see* Part A.3., *infra*), petitioner does not attempt to advance one. In determining whether loan charges exceeded statutory ceilings on "interest," courts have commonly included in their calculations not only flat charges, but even charges paid in goods rather than money.[14] If such charges were not included, the legal limits on interest could be easily circumvented. Indeed, consumer credit statutes often express limits on monthly finance charges, and late charges, in both percentage terms and flat terms.[15]

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[13] *See also Scofield v. McNaught*, 52 Ga. 69, 71 (1874) (seller of house violated ten percent usury ceiling by requiring purchaser to pay $700 per year flat rental charge, court noting that "calling it rent need not alter the legal effect of the transaction so far as the question of usury is concerned"); *Mills v. Salisbury Bldg. & Loan Ass'n*, 75 N.C. 292, 299 (1876) (total amount of interest, dues, and fines levied for failing to pay timely the various monthly payments exceeded usury ceiling); *Hollowell v. Southern Bldg. & Loan Ass'n*, 26 S.E. 781 (N.C. 1887) (charge of $5 as "interest" and $12 as "dues" amounted to more than the legal interest rate); *Meroney v. Atlanta Nat'l Bldg. & Loan Ass'n*, 21 S.E. 924 (N.C. 1895) (holding that association charges, including a "sum of $3 per month as interest and premium on said advance," were usurious).

[14] *See, e.g., Smith v. Smith*, 45 Pa. Super. 353, 356-57 (1911) (holding that it was "immaterial in what form or pretense" the interest was charged and that four atlases given as bonus for a loan were within usury statute); *Eason v. Saulsbury, Respess & Co.*, 51 Ga. 507 (1874) (charge paid in cotton); *Heytle v. Logan*, 1 A.K. Marsh. 529 (Ky. 1819) (charge paid in real estate).

[15] *See, e.g.*, Uniform Consumer Credit Code ("UCCC") § 3.201 (1968 Act) (maximum credit service charge on revolving loans of X% annually or 50 cents per month, whichever is larger); UCCC

In response, petitioner argues that "interest" as used in section 85 must be limited to percentage charges because section 85 refers to "interest at the rate allowed" and only a percentage charge can be a "rate." This argument fails for two reasons.

First, section 85 provides that "the laws of the State, Territory, or District" shall determine the "rate allowed," and the statute does not limit such laws to those specifying percentages. As a matter of ordinary English usage, in the nineteenth century and now, a "rate" need not be a "percentage rate."

The leading nineteenth-century American dictionary defined "rate" as: "[p]rice or amount stated or fixed on anything," and then gave the following examples of this particular usage: "A king may purchase territory at too dear a *rate*. The *rate* of interest is prescribed by law." 2 Noah Webster, *American Dictionary of the English Language* (N.Y., S. Converse ed., 1828) (emphasis in original). There can be no doubt that this definition encompassed flat charges.

Modern definitions of "rate" are equally broad. *See* 13 *Oxford English Dictionary* 208 (1989) ("a fixed charge applicable to each individual case or instance"); *see also Webster's Third New International Dictionary* (Unabridged) 1884 (2d ed. 1971) ("a fixed or established portion or measure").[16] In modern usage, the word "rate"

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§ 2.202 (1974 Act) (same); UCCC § 3.203 (1968 Act) (late charge on precomputed loan of $5 or 5% of the unpaid installment, whichever is larger, "however long it remains in default"); UCCC § 2.502 (1974 Act) (same). Many states have adopted these UCCC model provisions or similar standards. *See U.L.A. Directory of Uniform Acts & Code* (1995 Pamphlet).

[16] *See also Random House Dictionary of the English Language* 1602 (2d ed. 1987) (definitions include "'price' or 'cost'" and the example given is "to cut rates on all home furnishings"); *Webster's Ninth New Collegiate Dictionary* 976 (1991) (first definition is "as reckoned value); *see also Black's Law Dictionary* 639 (6th ed. 1990) ("Flat Rate: Fixed amount paid each period without regard to actual amount of electricity, gas, etc. used in that particular period").

includes, for example, the flat per-night cost of a hotel room ("hotel rates"), flat "telephone rates" for installing a line, and flat fares for transportation of goods or persons, which are regulated as "rates."[17]

Second, state usury statutes that use the word "rate" in a phrase like "interest at the rate" have, for centuries, been routinely applied to flat charges. *See supra* pp. 20-21. It is just a matter of arithmetic to determine whether a fixed charge, alone or together with other charges, exceeds a state ceiling expressed as a percentage. Thus, the issue has never been whether the particular state's ceiling on interest, if there is one, is stated in terms of a "rate." The issue, instead, is whether flat charges for borrowed money are "interest," such that they count against that "rate" ceiling; if not, the state's ceiling could be evaded with impunity.

If flat charges are "interest" for purposes of determining whether the lender's charges exceed a state-specified ceiling, they are equally "interest" in a state like South Dakota that sets no ceiling and allows whatever charges are agreed between lender and borrower. The point is illustrated by *Daggs v. Phoenix National Bank*, 177 U.S. 549 (1900). That case involved a national bank located in Arizona. Arizona's usury statute specified a percentage-rate ceiling on "interest" in the absence of a contract, but permitted parties to agree by contract to any "rate of interest." *See id.* at 554. The issue under section 85 was whether "the rate allowed" in Arizona encompassed any amount of interest agreed between the national bank and a borrower, even though Arizona had specified no "rate of interest" whatsoever for contracting parties. The Court's answer was yes: "[t]he intention of the national law is to adopt the state law, and permit to national banks what the state law allows to its citizens and to the banks

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[17] *See, e.g., Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 388 (1992) (holding that National Association of Attorneys General guidelines that referred to "air fares" related to "airline rates" for purpose of the Airline Deregulation Act of 1978).

organized by it." *Id.* at 555.[18] The principle recognized in *Daggs* was that a state can remove all restrictions on the "rate of interest" to which parties can agree; and if a state, following the example of Arizona, permits lenders and borrowers to agree upon unlimited amounts of interest at unrestricted rates, national banks and their borrowers have the same right.[19]

Petitioner concedes that flat charges (such as Citibank's 50-cent minimum finance charge) may be "interest" (Br. 30), but appears to limit that concession to flat amounts charged prior to the default on a loan. But there is no logical or economic reason to distinguish between flat amounts charged before maturity for the use of money and flat amounts charged after default for the money's use and detention. In either case, borrowers, lenders, and courts can and do calculate whether flat loan charges, when added to any other charges, have exceeded that ceiling. While it may not be possible to determine whether a certain late charge exceeds a given percentage ceiling until after the charge is actually incurred (because the account is a revolving one), that has no bearing on whether such a ceiling can in fact be applied. *See Paulat v. Pirello*, 353 So. 2d 1307, 1310 (La. 1977) (even if a note is not usurious on its face, payments made following maturity of the note that in fact exceed the usury rate constitute usurious interest); *Dixon v. Brooks*, 604 S.W.2d 330, 333-34 (Tex. Civ. App. 1980) (under Texas law, "[t]o be liable for usury penalties, one must contract for, charge or receive interest which is greater than the amount authorized by law") (emphasis added); *A.Y. McDonald Mfg. Co. v. Shackelford*, 652 S.W.2d 8, 9 (Ark. 1983) ("the debtor need not agree to a usurious rate of interest in order for the charge to be void; it is enough that the rate is charged") (citation omitted).

Finally, petitioner is also wrong in asserting that the clause in section 85 that gives national banks the alternative of charging interest "at a rate of 1 per centum per annum in excess of the [Federal Reserve] discount rate" means that the bank's charges must be stated as percentages. In the first place, this provision, which was added to the statute in 1933, simply provides an alternative to the "state rate" and there is no evidence that it was intended to alter the meaning of the language at issue in this case.[20] More fundamentally, it is clear for the reasons already discussed that even if the Federal Reserve rate were always expressed in percentage terms, there is no reason why a flat charge would not count in determining whether that ceiling was exceeded.

3. *Charges for the Detention of Money Are "Interest" Even if the Charges Are Not Shown To Be Compensatory or Are Labeled "Penalties"*

Petitioner asserts that Citibank's charges are not "interest" but "penalties." The distinction, however, relates only to the enforceability of interest and not to its definition or scope. A charge for the detention of money past its due date is "interest" even if, under applicable law,

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[18] Petitioner cites *National Bank v. Johnson*, 104 U.S. 271 (1881), for the contrary proposition; that is, that Congress intended only to adopt the states' numerical percentage limits (Br. 4, 19, 23, 24). The Court in *Daggs* specifically rejected the interpretation of *Johnson* that petitioner advances, noting that any remarks in *Johnson* "which seemed to imply that a rate allowed by a state law" was limited to a "fixed" numerical percentage "were not necessary to the decision, and cannot be considered as expressing the judgment of the court." *Daggs*, 177 U.S. at 556.

[19] *Cf. Citizens Nat'l Bank v. Donnell*, 195 U.S. 369, 373 (1904) (section 85 adopts national bank's home state's law concerning permissible means of calculating the "rate" of interest).

[20] The legislative history of the 1933 Act provides little insight into congressional intent regarding this addition, although Representative Luce characterized the discount rate clause as a "minor provision." *See* 77 Cong. Rec. 3916 (1933).

it is deemed to be "punitive" and (perhaps) therefore not enforceable.[21]

This Court has already held that an amount that a national bank actually charges (and a borrower agrees to pay) for borrowed money is "interest," even if it might be labeled a "penalty." In *Citizens' National Bank v. Donnell*, 195 U.S. 369 (1904), a national bank had assessed an overdraft charge of 12 percent, which exceeded the amount allowed by its home state. The lender sought to avoid what is now section 85 by arguing that "this charge was a penalty because of a failure to pay a debt when due, and therefore not usurious." *Id.* at 373-74. The Court swiftly dismissed this argument, holding that the charge was covered by (and violated) section 85.

The Court's holding in *Donnell* is only one of a long line of cases recognizing that contracted-for post-default charges are "interest" regardless of whether they can *also* be characterized as "penalty" charges.[22] For example, in *Hubbard v. Callahan*, 42 Conn. 524 (1875), the defendant borrower argued that an agreed-to post-default rate

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[21] As one annotator summarized the judicial decisions addressing late-payment charges: "[w]hile a number of cases have treated such stipulations as 'penalties,' the term 'penalty' has been used in different senses, and thus the 'penalty' characterization does not provide a useful, independent basis for categorization." Gary D. Spivey, Annotation, *Validity and Construction of Provision Imposing "Late Charge" or Similar Exaction for Delay in Making Periodic Payments on Note, Mortgage or Instalment Sale Contract*, 63 A.L.R. 3d 50, 58-59 (1975).

[22] *See, e.g.*, *Union Estates Co. v. Adlon Const. Co.*, 116 N.E. 984, 985 (N.Y. 1917); *National Life Ins. Co. v. Hale*, 154 P. 536, 537 (Okla. 1916) (citing additional authority); *Havemeyer v. Paul*, 63 N.W. 932, 937 (Neb. 1895); *Reeves v. Stipp*, 91 Ill. 609, 611 (1879); *Dorris v. Merrill*, 33 Ark. 416 (1878); *Capen v. Crowell*, 66 Me. 282 (1877); *Downey v. Beach*, 78 Ill. 53, 54 (1875); *Davis v. Hendrie*, 1 Mont. 499, 505 (1872); *Wilson v. Dean*, 10 Iowa 432, 433 (1860); *Horner v. Hunt*, 1 Blackf. 213, 214 (Ind. 1822); *Waller v. Long*, 20 Va. (6 Munf.) 71, 78 (1818); *see also* cases cited in 12 A.L.R. 363, 363-64 (1921).

of 15% was not "interest," under a statute providing that "it shall be lawful to contract for the payment and receipt of any rate of interest," because the amount exceeded what was needed to compensate the lender and therefore constituted a "penalty." *Id.* at 526-27. The court flatly rejected that argument with the following reasoning:

> It would strike most commercial and business men with surprise, if they were told that *all that is received or paid for the use of the money* so loaned was not interest, but mere damages for the breach of contract, and that the parties could not, if they would, make it interest, even by an express agreement to that effect.
>
> If then there is any limitation of the power of parties to contract in this regard, it must be found in some extremely technical definition of the word "interest" as used in the statute. *And the defendant's claim is that the word "interest" in law necessarily imports a compensation for the use of money until the principal is due. This claim however is not well sustained by authorities.*

Id. at 528 (emphasis added). *See also id* at 528-35 (citing extensive precedent).[23]

While petitioner asserts a rigid distinction between "interest" and "penalties," her cases show no such thing. They show only that there were exceptions to the law of usury, so that an amount that was regarded as "interest" might or might not be "usurious."[24] In *Lloyd v. Scott*, 29 U.S. (4 Pet.) 205, 226 (1830) (cited Br. 33), the Court held that plaintiff borrower should be permitted to

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[23] *See also Library of Congress v. Shaw*, 478 U.S. 310, 314 n.2 (1986) (the institution of interest originated under Roman law as a penalty due from a debtor who delayed or defaulted in repayment of a loan).

[24] For a further explanation of the distinction between "usury" and "interest," see J. Kelly, *A Summary of the History and Law of Usury in England* *60 (1852), *reprinted in The Law Library* (Phila., T. & J.W. Johnson, Law Booksellers 1852).

show that an "annuity," which would have been outside the usury laws, was an artifice to evade those laws; the case had nothing to do with the definition of "interest." In *Spain v. Hamilton's Adm'r,* 68 U.S. (1 Wall.) 604 (1863) (cited Br. 33), the Court said, conversely, that the borrower's agreement to forfeit certain funds did not render a loan usurious, because there was no evidence that the forfeiture was an artifice to evade the usury laws; again, the case had nothing to do with the definition of "interest." Finally, the court in *Merchants' Nat'l Bank v. Sevier,* 14 F. 662 (C.C.D. Ark. 1882) (cited Br. 36-37), noted that states were divided on the enforceability of contract clauses requiring a defaulting borrower to pay an attorney's fee, *id.* at 662-63, but held that such a clause was a cover for usury and unenforceable in Arkansas, *id.* at 665. As in *Lloyd* and *Spain,* the court did not discuss the meaning of the term "interest."

Petitioner alleges that although she agreed to Citibank's charges, they are more than is necessary to compensate Citibank for the costs of her default. (Br. 38-39). But this is just an argument that Citibank's charges are in her view too high and unfair given the circumstances of the loan. Section 85 commits that question to the laws of Souht Dakota: Petitioner is not entitled to a determination under California law of whether the charges are excessive because they are allegedly "supracompensatory" or for any other reason.

To be sure, in the nineteenth century, different states had, as they do today, different policies governing when interest charges become "unfair," "non-compensatory," or "punitive," and therefore unenforceable. In many cases, ordinary percentage charges, which petitioner concedes are "interest," were labeled "punitive" and not enforceable.[25] Other courts, in other states, found very similar

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[25] *See, e.g., Scottish-American Mortgage Co. v. Wilson,* 24 F. 310, 312 (C.C.D. Kan. 1885) (provision that upon default, interest on principal sum would increase from 7% to 12% retroactive to making of note was unenforceable penalty); *Connecticut Mut. Life*

interest charges enforceable because the parties had agreed to them.[26] *See New Orleans v. Warner,* 175 U.S. 120, 147 (1899) ("where there is a promise to pay upon a certain day with interest at an exorbitant rate, the creditor is only entitled to interest after that time by operation of law and not by contract; although if the local law be different this Court will follow it."). The crucial point, however, is that courts on both sides of the divide referred to such charges as "interest." [27]

Ins. Co. v. Westerhoff, 78 N.W. 724, 725 (Neb. 1899) (provision that upon default in an installment payment the entire principal would bear interest at higher rate was unenforceable penalty); *Krutz v. Robbins,* 40 P. 415, 416 (Wash. 1896) (same); *Conrad v. Gibbon,* 29 Iowa 120, 121 (1870) (similar to *Scottish American*); *Mosby v. Taylor,* 21 Va. (Gilmer) 172, 173 (1821) (same); *Smithers v. Gough,* 2 Ky. (Sneed) 346 (1805) (same).

[26] *See, e.g., Fisher v. Anderson & Froth,* 25 Iowa 28, 30 (1868) (holding that increased interest from the time of the making of the note could be recovered); *Rogers v. Sample,* 33 Miss. 310, 312 (1857) (same, and recognizing conflict); *C.B. Bowler & Co. v. Houston,* 1 Ohio Dec. 560, 507 (Ohio C.P. 1851); *Gully v. Remy,* 1 *Blackf.* 68, 70 (Ind. 1820) (same); *Ramsey v. Matthews,* 4 Ky. (1 Bibb) 242, 243 (1808) (same, and recognizing conflict).

[27] *Compare Nicholls v. Maynard,* 3 Atk. 519, 520 (Eng. Ch. 1747) ("Where the *interest* is to be increased, if not paid at the day, that is but as a *nomine poenae,* and relievable in equity"); *Strode v. Parker,* 2 Vern. 316, 317, 23 Eng. Rep. 804, 805 (Ch. 1694) ("where the interest is to be increaser, if not paid at the day, *that* is but in the nature of a penalty and relievable in equity"); *with Fisher v. Anderson & Froth,* 25 Iowa 28, 30 (1868) (holding that increased *interest* from the time of the making of the note could be recovered); *Rogers v. Sample,* 33 Miss. 310, 312 (1857) (same, and recognizing conflict); *C.B. Bowler & Co. v. Houston,* 1 Ohio Dec. 506, 507 (Ohio Ct. Common Pleas 1851) ("the note in controversy was a good contract, and the *interest* from date could be collected"); *Gully v. Remy,* 1 Blackf. 69, 70 (Ind. 1820) ("The *interest* it is contended, is nothing more than a penalty"; but lower court "acted rightly in allowing interest on the obligation from its date"); *Rumsey v. Matthews,* 4 Ky. (1 Bibb) 242, 243 (1808) (rejecting argument that "*interest* from the date provided the principal is not paid by a particular day, can only be considered as a *nomine peonae*"). (All emphasis added). As one commentator observed, the cases "held or recognized that it was not usurious to provide in a promissory note or other contract for the payment of

Petitioner's contention that it is possible to determine *a priori*, based on the form of a charge, whether it is "compensatory" and then to use this determination to decide which state(s) have regulatory jurisdiction over a particular charge, is wrong on two counts. First, petitioner's claim (Br. 30-31, 31 n.14, 32-33) that a charge is inherently not compensatory if it is not expressed as a percentage of the loan and measured by time[27] has no merit. Lenders' costs include not only the time value of the money lent but other costs that may not be proportional to either the balance or the time, including the costs of setting up and administering individual accounts; tracking defaults and adjusting the rights of defaulting borrowers; collecting amounts in default; and losing part or all of the principal when a late payer later becomes a nonpayer.[29] A lender might attempt to

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money, for *interest* after maturity at a rate in excess of the lawful rate . . . (because) such a provision is in the nature of a penalty which has as its purpose the iducement of prompt payment of money owed when due." J.D. Perovich, Annotation, *Provision for Interest After Maturity at a Rate in Excess of Legal Rate as Usurious or Otherwise Illegal*, 28 A.L.R. 3d 449, 454 (1969). (Emphasis added).

[28] Citibank's late charges do, of course, accrue "over time." They are charged on a per-month basis for each monthly period in which a borrower delays repayment for more than 25 days after the due date (or, in the case of the Preferred Card, for more than 15 days in the first month and 30 days in succeeding months). *See* pp. 5-6, *supra*.

[29] *See Meilink v. Unemployment Reserves Comm'n (In re United Lamp & Shade Corp.)*, 314 U.S. 564, 567 (1942). Petitioner argues that the court in *Meilink* recognized a distinction between penalties and "interest." That case does not recognize petitioner's distinction and, in fact, controverts her argument that "interest" charges must be compensatory. In *Meilink*, the court considered whether a "twelve percent per annum" interest charge was dischargeable as a "penalty or forfeiture" under the Bankruptcy Act, where the relevant state law provided a seven percent usury ceiling. *Meilink*, 314 U.S. at 566. The Court held that the charge was not a penalty, even though it was above the legal rate, and went on to note that "[w]e cannot be so confident here that . . . an exaction in excess of such value [for the use of money] cannot be merely an interest charge." *Id.* at 569.

recover all of these costs through a sufficiently high percentage rate on all outstanding balances, but it may also, as Citibank and other lenders have done, offer more tailored packages of charges that are expected to recover their costs[30] and be more attractive to most customers. Packages that include late fees are economically rational because they enable the lender to collect from defaulting borrowers a portion of the extra costs they impose. This allows the lender to reduce the percentage finance charge to borrowers who pay on time. Given the myriad of economic factors and borrower preferences bearing on the pricing of credit, there can be no universal test for determining whether the chosen fabric of lending charges —let alone a single strand of the weave—is "compensatory."

Second, the fundamental point of section 85 is that the question whether all or some of a lender's package of charges should be disallowed—because the charges exceed some determination of what is needed to compensate the lender, or exceed a specified ceiling, or exceed some other measure of appropriate amount—is to be determined under the law of the national bank's home state. States may choose to regulate such charges in any of a variety of ways. State *A's* legislature, for example, might hold hearings and determine that a specified flat fee or percentage-rate charge is sufficient and impose that as a ceiling. State *B's* courts might (notwithstanding the practical difficulties) require the lender to prove its actual costs incurred on a particular credit card loan or on average. State *C* might decide that with many lenders competing intensely in a nationwide credit card lending market *no* regulation of interest charges is warranted. But whatever the method chosen by a particular state to regulate the rate of interest, section 85 makes clear that national banks located within that state will be allowed to

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[30] *See, e.g.*, *Marquette*, 439 U.S. at 302-03 (flat annual fees can compensate credit card lender who offers lower annual percentage rate for finance charges).

charge that rate, and it denies any other state the right to impose its own views of what charge is appropriate. Petitioner is simply trying to apply California law to a legal issue that section 85 assigns to the law of South Dakota.

B. The Purpose of Section 85 Requires That "Interest" Include All Charges for the Use or Detention of Money, Including Flat Late-Payment Charges

As petitioner admits (Br. 3-5), Congress enacted section 85 of the National Bank Act in 1864 to protect national banks against the "hazard" of "unfriendly state legislation." *Tiffany*, 85 U.S. (18 Wall.) at 412. Congress was concerned that state governments might attempt to restrict the lending power of the newly chartered national banks that were being created to help finance the Civil War and stabilize the Union's economy. Bray Hammond, *Sovereignty and an Empty Purse* 290 (1970).[31] Thus, Congress intended to protect national banks by ensuring that they would be able to charge interest "on precisely the same footing [as state-regulated lenders] doing business in [their home] State by its laws." Cong. Globe, 38th Cong., 1st Sess. 2126 (1864) (remarks of Senator Sherman).

If section 85 is to achieve its "most favored lender" purpose, "interest" must be understood, in accordance with its ordinary meaning in similar contexts, to cover all "compensation allowed by law, or fixed by the parties, for the use or forbearance of money, or as damages for its detention." *Hiatts*, 82 U.S. at 185. As several courts have pointed out, if "interest" were not interpreted to cover charges for borrowed money other than percentage finance charges, national banks could be at a disadvantage compared with rival state-regulated lenders. *See Greenwood Trust*, 971 F.2d at 827 & n.8; *Fisher v. First Nat'l*

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[31] In fact, the National Bank Act became politically feasible only because of the secession of the states that had led the attacks on the First and Second Banks of the United States. 1 *A History of Banking in All the Leading Nations* 464 (William G. Sumner ed.) (1896).

Bank, 548 F.2d 255, 259-60 (8th Cir. 1977); *Northway Lanes v. Hackley Union Nat'l Bank & Trust Co.*, 464 F.2d 855, 862 (6th Cir. 1972). Similarly, the OCC has explained that "Congress intended the term 'interest' in section 85 to include any kind of lending charge allowed to state lenders in order to achieve Congress' goal of putting national banks on at least as strong a footing as the most favored lender subject to state control." Julie L. Williams, OCC Chief Counsel, Interpretive Letter No. 670, [1944-1995 Transfer Binder] Fed. Banking L. Rep. ¶ 83,618, at 71,834 (Feb. 17, 1995).

For example, under the construction of section 85 proffered by petitioner, a state could permit a favored class of lenders (perhaps credit unions or finance companies or individuals) to assess late charges without extending the same right to banks. If section 85 did not apply to such charges, banks, including national banks, would be at a disadvantage and would be forced to increase other charges to compensate for the revenue they could not obtain from late charges. As a result, national banks could not compete on a level playing field with the favored lenders. That result would not necessarily be unconstitutional (if the distinction between different kinds of lenders were rational and the line were not drawn between in-state and out-of-state lenders), but it would deprive national banks of their statutory most-favored-lender position.

The example is true to life. Until recently, California law allowed California-chartered credit unions to charge late fees at a flat rate of $5,[32] but subjected banks to standards that might impose lower limits.[33] In order to place national banks on the same footing as the "favored" credit unions in California, section 85 must apply to flat late charges.

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[32] *See* Cal. Fin. Code Ann. § 15001 (West 1989).

[33] *E.g., Beasley v. Wells Fargo Bank, N.A.*, 1 Cal. Rptr. 2d 446 (Cal. App. 1991).

The legislative history of section 85 further supports the conclusion that Congress intended an inclusive reading of "interest." The debates reveal that Congress decided to empower national banks to collect interest at the rate "allowed" rather than "established" by their home states in order to ensure that national banks would have the benefits of state laws allowing lenders and borrowers to contract for *any* rate of interest.[34] In *Daggs, supra,* 177 U.S. at 555, this Court confirmed that Congress chose the term "allowed" in order to give national banks the right to assess any agreed-upon rate of interest in those states [35] in which such agreements were enforceable, even

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[34] The version of section 30 of the National Bank Act reported to Congress by the Senate Finance Committee used the phrase "[t]he rate *allowed* by the laws of the State or Territory where the bank is located, and no more." *See* Cong. Globe, 38th Cong., 1st Sess. 1871 (1864) (emphasis added). Senator Grimes of Iowa proposed amending the bill to replace the word "allowed" with "established." *See* Cong. Globe, 38th Cong., 1st Sess. 2124. Senator Grimes sought to limit national banks to the legal rate of interest affirmatively authorized by the state and to prohibit national banks from agreeing to a higher rate in the contract (as thirteen state and territorial usury statutes parmitted local lenders to do). *See id.* at 2125 (remarks of Sen. Grimes). Senators from states whose statutes permitted parties to agree to any interest set forth in the contract emphasized, however, that their home states' banks would not take federal charters unless the language was broadened to permit a national bank to charge any interest "allowed" by the laws of the bank's home state, thus ensuring that the national banks could charge whatever interest was available to private parties by contract. *See, e.g.,* Cong. Globe, 38th Cong., 1st Sess. 2126 (remarks of Sen. Trumbull); *id.* at 2127 (remarks of Sen. Fessenden). The members advocating broader lending powers for national banks won the debate.

[35] *E.g.,* Act of Mar. 10, 1887, tit. 38, § 2, 1887 Ariz. Rev. Stat. 383; Act of Mar. 20, 1989, ch. 92, §§ 1, 2, 1858 Ark. Stat. Dig. 621, 621-22; Act to Regulate the Interest of Money, ch. 31, § 2, 1850 Cal. Stat. 92 (1850); Act to Prescribe the Rate of Interest, § 3, 1861 Colo. Sess. Laws 45 (1861); Act to Legalize Ten Per Cent. Interest When It Is Agreed upon Between Parties, §§ 1, 2, 1857 Ill. Laws 45, 45-46 (1857); Act to Regulate the Interest on Money, ch. 72, §§ 1787, 1788, 1860 Iowa Rev. 316 (1853); Act Concerning the Rate of Interest, ch. 56, § 2, 1867 Mass. Acts 500 (1867);

when such states—like Arizona in *Daggs* and South Dakota (among other states) today—had no interest "rate expressed in the laws," and "allowed" lenders to charge any amounts to which a borrower agreed. *Id.*

In sum, section 85 would not achieve its broad purpose of protecting national banks against hostility in their home state unless "interest" is defined to mean all charges for the use, detention, or forbearance of money. Petitioner does not, and could not, argue that the word "interest" as used in section 85 has two different meanings, a broader meaning when the borrower resides in the bank's home state and a narrower meaning when she resides elsewhere. Nor can she properly argue that California has a stronger interest in regulating Citibank's charges than its home state does; on the contrary, as the Court held in *Marquette,* Congress, legislating against the background of a "developed interstate loan market," 439 U.S. at 317-18, chose to incorporate the interest law of the bank's home state and to require borrowers' states to "give way," *id.* at 318 n.31. Allowing a borrower's state to regulate one component of the bundle of charges that are otherwise beyond its reach would merely disrupt the interstate loan market that section 85 has fostered. *See Marquette,* 439 U.S. at 312 (declining to interpret "located" in section 85 in a way that would "throw into confusion the complex system of modern interstate banking").

C. The Office of the Comptroller of the Currency Has Consistently Interpreted Section 85 To Cover Late-Payment Charges

This Court has said more than once that when a court is required to construe a federal statute that has been the

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Act Fixing the Rate of Interest, ch. 56, § 1, 1860 Minn. Laws 226 (1860); Act of Mar. 24, 1845, ch. 88, §§ 1, 2, 1845 Mo. Rev. Stat. Neb. Laws 205, 205-6 (1855); Act in Relation to Money of Account and Interest, ch. 34, § 5, 1861 Nev. Sess. Laws 99, 100 (1861); Act in Relation to Interest, § 1, 1876 Utah Laws 170 (1869); Act to Regulate the Interest of Money, § 2, 1854 Wash. Laws 380 (1854).

subject of federal administrative interpretation, and the court "determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation." Instead,

> if the statute is silent or ambiguous with respect to the specific issue, *the question for the court is whether the agency's answer is based on a permissible construction of the statute.*

Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 843 (1984) (emphasis added).

In particular, the Court has required such deference to the OCC on questions of interpretation of ambiguous provisions of the National Bank Act. *See NationsBank, N.A. v. Variable Annuity Life Ins. Co.*, 115 S. Ct. 810, 813-14, 816 (1995) (in defining term "insurance" as used in the Act, if "the administrator's reading fills a gap or defines a term in a way that is reasonable in light of the legislature's revealed design, we give the administrator's judgment 'controlling weight' ").

The OCC is the exclusive supervisor of national banks. Few if any other fields of commerce are subject to the level of governmental supervision given to national banks.[36] This supervision runs to "all the affairs of the bank," 12 U.S.C. § 481, including consumer credit regulation.[37] Accordingly, to the extent that Congress has not itself directly spoken to the precise question at issue here—the meaning of "interest" in section 85—the OCC's interpretation

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[36] *See, e.g.*, 12 U.S.C. § 481 (examination by OCC), § 1818(b)(1) (OCC enforcement authority regarding national bank violation of "any law"). State officials may not exercise any visitorial powers over a national bank, except in regard to certain state escheat laws. 12 U.S.C. § 484; 12 C.F.R. § 7.4001, as revised, 61 Fed. Reg. 4849 (Feb. 9, 1996).

[37] *See, e.g.*, OCC, *An Examiner's Guide to Consumer Compliance* (1993); *Comptroller's Handbook for National Bank Examiners* § 212 (credit card plans).

should be given "controlling weight." *See NationsBank*, 155 S. Ct. at 813-14.

In this case, two of the reasons for deferring to the expert agency are present in especially strong form. First, bank loan charges can and should—given a well-functioning market—take many forms, and the OCC's expertise in the mechanics and economics of lending is therefore crucial in sorting out which charges should count as "interest." Second, both banks and state governments have asked for and relied on the OCC's views.

On February 9, 1996, the OCC, following notice-and-comment rulemaking procedures, published an extensive set of rules interpreting various provisions of the Act. *See* 61 Fed. Reg 4849 (1996). Among them was a rule to be codified at 12 C.F.R. § 7.4001, which reads in pertinent part as follows:

> (a) *Definition.* The term "interest" as used in 12 U.S.C. 85 includes any payment compensating a creditor or prospective creditor for an extension of credit, making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended. It includes, among other things, the following fees connected with credit extension or availability: numerical periodic rates, *late fees,* not sufficient funds (NSF) fees, overlimit fees, annual fees, cash advance fees, and membership fees. It does not ordinarily include appraisal fees, premiums and commissions attributable to insurance guaranteeing repayment of any extension of credit finders' fees, fees for document preparation or notarization, or fees incurred to obtain credit reports.

61 Fed. Reg. at 4869 (emphasis added).

The OCC's Federal Register statement concerning this regulation described it as intended to codify past "interpretive positions," 61 Fed. Reg. at 4858, and that description is accurate. For example, in a letter issued on February 17, 1995, the OCC's Chief Counsel, responding to a bank request, expressed the "opinion of the Office of the

Comptroller of the Currency" that late fees are "interest" governed by section 85:

> By its terms, section 85 is broadly written to apply to all interest charged as compensation for a loan. The National Bank Act was an expansively written statute designed to be an outline for a new national banking system. The Act did not contain a specific definition of the term "interest" and the term "interest" did not have any single narrow definition in the judicially-made law of that time. In general, the term was understood to include all "compensation allowed by law, or fixed by the parties, for the use or forbearance of money, or as damages for its detention." Congress intended for the term "interest" in section 85 to be understood broadly to include any kind of lending charge allowed to state lenders in order to achieve Congress' goal of putting national banks on at least as strong a footing as the most favored lender subject to state control.[38]

Specifically with respect to late fees, the Chief Counsel stated:

> Credit card late fees are increased charges to borrowers who engage in delinquent payment behavior in order to compensate the bank for . . . increased lending costs and risks . . . . [They] are in addition to the basic monthly percentage finance charge on the account, and they represent an increased lending charge applicable when the customer retains the bank's money beyond the agreed upon date of payment. Accordingly, they are "interest" under the classic definition articulated in *Brown* [*v. Hiatts, supra*] and similar cases . . . .[39]

Prior OCC statements are in accord, as the Chief Counsel's letter itself recites at length. For example, responding in 1980 to a request from the Pennsylvania Attorney General, the OCC stated that Pennsylvania could not limit credit card annual fees charged by out-of-state national banks because such charges are "interest" governed by section 85 and the law of the bank's home state.[40] In 1992, the OCC advised a bank, in response to its query, that Iowa law could not limit an out-of-state national bank's "charges for late payment," again because such payments are "interest" for section 85 purposes.[41] This conclusion echoed advice given directly to the State of Iowa in 1988 specifically with respect to Citibank's "late fees, charges for [insufficient funds checks], and cash advance fees," all of which the OCC said are "interest" covered by section 85.[42]

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[38] Julie L. Williams, OCC Chief Counsel, Interpretative Letter No. 670, [1994-1995 Transfer Binder] Fed. Banking L. Rep. ¶ 83,618, at 71,834 (Feb. 17, 1995).

[39] *See id.* at 86,696.

Petitioner argues (Br. 27-28), citing *Adams Fruit Co. v. Barrett*, 494 U.S. 638 (1990), that the OCC is not entitled to deference because there has been no "congressional delegation of administrative authority." That argument is entirely wrong: the OCC has the power to supervise national banks to assure their compliance with, among

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[40] *See* Letter from Richard V. Fitzgerald, Director, OCC Legal Advisory Services Division 3-4 (Nov. 24, 1980) (R. App. B).

[41] Letter from William P. Bowden, Jr., OCC Chief Counsel, 1992 WL 136390 (OCC), at *1, 3-4 (Feb. 4, 1992) (citations omitted).

[42] *See* Robert B. Serino, Deputy Chief Counsel (Policy), Interpretive Letter No. 452, [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,676, at 78,064 (Aug. 11, 1988). *See also, e.g.*, Letter from Kenneth W. Leaf, OCC Chief National Bank Examiner 2 (Feb. 13, 1974) (section 85 governs " 'all reasonable and necessary charges incurred in connection with the making, closing, disbursing, expending, readjusting or renewing of . . . loans' ") (citation omitted) (R. App. C); Letter from W.M. Taylor, Deputy Comptroller of the Currency (June 10, 1961) (service charges) (R. App. D); Letter from W.M. Taylor, Deputy Comptroller of the Currency (June 1, 1956) (fees for expenses) (R. App. E); Letter from L.A. Jennings, Deputy Comptroller of the Currency (Feb. 24, 1955) (delinquency charges) (R. App. F); Letter from R.B. McCandless, Deputy Comptroller of the Currency (Sept. 3, 1947) (service charges) (R. App. G); Letter from J.L. Robertson, Deputy Comptroller of the Currency (Feb. 4, 1946) (set-up charges, collection charges) (R. App. H).

other provisions, section 85. *See* p. 36, *supra.* In *NationsBank,* the Court deferred to the OCC's interpretation of another section of the National Bank Act, not because of any such express delegation of interpretive authority but because the OCC is " 'charged with the enforcement of the banking laws to an extent that warrants the invocation of [the deference] principle with respect to [the OCC's] deliberative conclusions as to the meaning of those laws.' " *NationsBank,* 115 S.Ct. at 813 (*quoting Clarke v. Securities Indus. Ass'n,* 479 U.S. 388, 403-04 (1987), and *Investment Co. Inst. v. Camp.,* 401 U.S. 617, 626-67 (1971)).

Petitioner also accuses the OCC of taking inconsistent positions and asserts that, accordingly, the OCC's views "do not warrant any deference." (Br. 27-29). Even if the premise were true, the conclusion would be false: an agency's present views are entitled to deference even if there have been revisions. *NationsBank,* 115 S. Ct. at 817; *Good Samaritan Hospital v. Shalala,* 113 S. Ct. 2151, 2160-61 (1993). The touchbstone, as always, is the reasonableness of the agency's determinations. *See id.*

In any event, the OCC's views have in fact been consistent over a long period.[43] Petitioner's primary evidence (Br. 28) to the contrary is a single 1964 letter attached to her brief at Appendix B; that letter does not even refer to section 85 and, according to the OCC itself, was concerned with the interpretation of state law, not section 85. *See* Julie L. Williams, OCC Chief Counsel, Interpretive Letter No. 670, [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83-618, at 71,837 n.13 (Feb. 17, 1995).[44] The California Supreme Court was entirely correct in concluding (P.A. 28 n.13) that this letter was not concerned with the meaning of "interest" in section 85. Petitioner offers no evidence at all to support her assertion that the OCC held a view contrary to its present view for "twenty-four (24) years." (Br. 28).

Petitioner also cites the 1988 OCC letter to Iowa, opining that Citibank's late charges *are* "interest" within the meaning of section 85, and argues that this letter impeaches the 1995 Chief Counsel's letter and the 1996 regulation because it follows a somewhat different analytical path to the same conclusion. (Br. 28). But while its analysis has naturally matured with further consideration, the OCC has never adopted any conclusion other than that section 85 authorizes a national bank to collect late fees at any rate, flat or otherwise, permitted by the laws of its home state.

D. DIDA and TILA Are Irrelevant to the Definition of "Interest" in Section 85

Petitioner contends that the legislative history of the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDA") demonstrates that section 85 was not intended by Congress to define "interest" to include post-maturity charges. (Br. 42-43). Petitioner claims that DIDA is relevant because section 521 through 523 of that statute parallel the language of section 85 for federally insured state-chartered banks, thrift institutions, and credit unions. (Br. 43-44).

The argument based on sections 521 through 523 of DIDA does not make sense. (P.A. 31). Congress' words in those provisions are essentially identical to section 85,

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[43] Petitioner asserts (Br. 29 n.13) that the OCC described its regulation as effecting a "significant change," but her quotation is misleading. The OCC's regulations have been changed only in that they now specifically address an issue previously addressed only in OCC letter interpretations. The OCC's Federal Register notice makes it clear, 60 Fed. Reg. at 11929, that the OCC did not consider the codification to represent a change in the OCC's legal views.

[44] Read most naturally, the 1964 letter says only that the charges in question were allowed in addition to the percentage rate authorized by the state laws referred to in the first paragraph of the letter.

and thus nothing in their statutory language is helpful in interpreting section 85. Moreover, there is no pertinent legislative history from the 1980 enactment of these provisions. If these provisions have any relevance, it is that when Congress re-codified section 522 of DIDA in 1989, without changing its language, the pertinent House Report did not confine the scope of that provision to percentage-based interest rates but instead described the statute as applying to all "loan-related charges." H.R. Rep. No. 54, 101st Cong., 1st Sess., pt. 1, at 343 (1989).[45]

Petitioner also relies on the legislative history of section 501 of DIDA, 12 U.S.C. § 1735f-7a(a)(1), a provision that deregulated rates for all lenders on purchase money mortgages for homes. (Br. 43 & n.1). Petitioner says that, while section 501 deregulated "interest," it did not deregulate late charges. The argument fails on at least two grounds. First, contrary to petitioner's contention, the language of the statute says plainly (and somewhat redundantly) that it is deregulating everything: "the rate or amount of interest, discount points, finance charges, or other charges which may be charged, taken, received, or reserved." 12 U.S.C. § 1735f-7a(a)(2). Second, section 501 of DIDA, which has no relationship to any provision in the National Bank Act and was enacted more than 115 years later, cannot possibly be understood as enunciating the intention of the 1864 Congress that adopted section 85.[46] *Central Bank v. First Interstate Bank*, 114 S. Ct. 1439, 1452 (1994). *See Greenwood Trust Co., supra*, 971 F.2d at 830 n.10.

Petitioner also refers to the exclusion of late charges from the definition of "finance charge" in "Regulation Z," 12 C.F.R. §§ 226.1 to 226.30 (1993), under the Truth-in-Lending Act ("TILA"), 15 U.S.C. §§ 1601 *et seq.*, as support for her argument that late charges should be excluded from the definition of "interest" in section 85. (Br. 46 n.25). There is, however, no relationship between TILA and the National Bank Act in scope, substance, terminology, history, or purpose. In any event, contrary to petitioner's suggestion, Regulation Z does not exclude late charges from any definition of "interest" and does not set any restrictions on what charges may be collected. Regulation Z merely prescribes the format in which credit charges, including late fees, must be disclosed. It separates certain items, including "charges for actual unanticipated late payment" from the definition of "finance charge" (a term given a special definition), to make them more apparent to consumers and not because they are outside the domain of interest. *See* 12 C.F.R. § 226.4(c). Each charge listed under section 226.4(c), including late-payment charges, would presumably be within the definition of "finance charge" but for the explicit exclusion. (P.A. 33-34).

II. SECTION 85 PRE-EMPTS CALIFORNIA LAW UNDER THE CIRCUMSTANCES OF THIS CASE

This case turns on a question of statutory interpretation: whether the term "interest" as used in section 85 of the National Bank Act includes charges imposed by Citibank for the late payment of credit card balances. If it does, then California law, to whatever extent it purports to limit such charges, is pre-empted. There is no separate issue of pre-emption theory or "federalism" in this case.

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[45] DIDA also included a section, codified at 12 U.S.C. § 86a, that paralleled section 85 with respect to certain agricultural and economic loans for all lenders. *See* Pub. L. No. 96-399, § 324(b), 94 Stat. 1614, 1648 (1980), *amending* Pub. L. No. 96-221, §§ 511, 512, 94 Stat. 132, 164 (1980). *See generally* 12 U.S.C.A. § 86a note. Revisiting that section a few months later, Congress enacted a definition clarifying that "interest" includes all compensation for a loan "however denominated." The legislative history is explicit that this definition was Congress' attempt to make sure that the ordinary meaning of interest, including all compensation, was clear; it did not purport to be changing anything. *See* 126 Cong. Rec. 16, 112 (1980) (Statement of Senator Proxmire, Chairman of the Senate Banking Committee). Section 86a is now sunsetted.

[46] Section 528 of DIDA is explicit that a national bank may charge any rate allowed by section 85 or by any provision of DIDA. Pub. L. No. 96-221, § 528, 94 Stat. at 168.

This Court has said consistently that "the purpose of Congress is the ultimate touchstone of pre-emption analysis."[47] That is, the ultimate question is whether the congressional purpose was to pre-empt state law under the circumstances at issue. Here, that question can be fully answered in three steps. First, as Citibank has shown, when Congress used the term "interest" in section 85, its purpose was to cover a range of charges for borrowed money that would include the charges at issue. Second, as petitioner nowhere disputes, Congress surely intended "interest" in section 85 to have the same meaning whether the loan at issue is intrastate or interstate. This meaning of "interest" is a federal question that does not depend on the borrower's state of residence or its law. Third, as this Court held in *Marquette*, when Congress said that a national bank "may take . . . interest at the rate allowed by the laws of [its home] State," its purpose was that a national bank be empowered to do so notwithstanding any contrary policy of a borrower's state, whose law "must, of course, give way to the federal statute." 439 U.S. at 318 n.31. *Cf. Barnett Bank v. Nelson*, No. 94-1837, slip op. at 5 (U.S. March 26, 1996) (finding "irreconcilable conflict" between federal statute providing that national banks "may" sell insurance and state statute forbidding them to do so; state statute is therefore pre-empted).

Petitioner argues that the "presumption against pre-emption" cuts across all this and requires a "crystal clear statement" (Br. 13), lacking in section 85, before the section can be read to pre-empt California's supposed "historic police power" to regulate late-payment charges of out-of-state national banks. But, first, this Court's cases require no such "crystal-clear statement": the presumption against pre-emption is merely one guide to discerning the purpose of Congress, of greater weight in some

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[47] *E.g., Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 516 (1992); *FMC Corp. v. Holliday*, 498 U.S. 52, 56-57 (1990); *Cotton Petroleum Corp. v. New Mexico*, 490 U.S. 163, 176 (1989).

cases than others, and capable of being overcome by other evidence.[48]

Moreover, there is no significant state interest that would support a presumption against pre-emption here. First, as the Court noted in *Marquette*, borrowers have always been free to obtain credit out-of-state, and under historic principles (in 1864 and before), such loans were customarily regulated by the state law of the lender, not of the borrower.[49] Second, states have never had the

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[48] *New York State Conference v. Travelers Ins. Co.*, 115 S. Ct. 1671, 1676 (1995) (reciting the presumption but only as one factor in determining congressional intent); *United States v. Bass*, 404 U.S. 336, 349 (1971) (same). Congressional intention to displace state law "may be evidenced in several ways." *Maryland v. Louisiana*, 451 U.S. 725, 746 (1981). *See, e.g., Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 382 (1992) ("Pre-emption may be either express or implied, and is compelled whether Congress' command is explicitly stated in the statute's language or implicitly contained in its structure and purpose"). This Court has often found pre-emption by simply construing a statute to determine what Congress intended, without looking for anything like a "crystal-clear statement." *E.g., Barnett Bank v. Nelson*, No. 94-1837 (U.S. March 26, 1996) (finding pre-emption based on language, structure, and purpose of National Bank Act); *American Airlines, Inc. v. Wolens*, 115 S. Ct. 817, 823 (1995) (finding pre-emption after considering both language and purpose of statute); *Allied-Bruce Terminix Cos. v. Dobson*, 115 S. Ct. 834, 839-40 (1995) (finding "broad" pre-emptive effect after considering language, background, structure, and purpose of statute).

[49] Under mid-nineteenth century conflict-of-laws principles governing contracts, the principle of *lex loci contractus* governed interest charges; that is, the law governing the rate of interest was the law of the state where the agreement was made. *See M'Queen v. Burns*, 8 N.C. (1 Hawks) 476 (1821); *Turpin v. Povall*, 35 Va. (8 Leigh) 93 (1837); *Houghton v. Page*, 2 N.H. 42 (1819). Moreover, courts rejected claims of usury on interstate loans, under the so-called "validating principle," if the lending charges were permitted under the laws of *either* the borrower's home state or the state in which the bank was located. *See Miller v. Tiffany*, 68 U.S. (1 Wall.) 298, 310 (1864); Story, *Commentaries on the Conflict of Laws* § 296, at 382 (6th ed. 1866); 2 Parsons, *Law of Contracts* 583-84 (1866).

power to regulate the overall cost of credit charged to their residents by out-of-state national banks. Under section 85, as interpreted in ***Daggs*** and ***Marquette***, a national bank located in a state that imposes no ceiling has always been able to charge a California borrower any amount of interest to which the borrower agrees; given that, any California stake in barring or limiting flat late fees would be highly attenuated at best. Third, the State interest asserted here (notably, by petitioner and not the State involved) cuts directly against the "most favored lender" purpose of section 85, and in that posture is not entitled to any presumption of Congressional deference. *See Barnett Bank v. Nelson*, slip op. at 7 ("In defining the pre-emptive scope of statutes and regulations granting a power to national banks, these cases take the view that normally Congress would not want States to forbid, *or to impair significantly*, the exercise of a power that Congress explicitly granted") (emphasis added).

Of course, a state that wants to assure that a state-blessed package of terms will be available to its residents can do so. It can authorize lenders located in that state to lend only on specified terms (and to advertise that they conform to state requirements). What it cannot do, and has not been able to do since before 1864, is prevent its residents from searching elsewhere (physically, telephonically, electronically, or through the mails) and agreeing to terms that they find there and prefer—such as a lower annual percentage rate on timely paid balances in exchange for an agreement to pay late charges if they default.

This case is thus quite unlike cases in which a federal statute is alleged to pre-empt a power inherent in state sovereignty, *e.g., Department of Revenue v. ACF Indus.*, 114 S. Ct. 843, 851 (1994) (state taxing power), or to replace state regulation of matters of local concern, *e.g., Cipollone*, 505 U.S. at 516 (health and safety).

In such cases, this Court has explained, Congress "should not lightly be taken to have significantly changed the federal-state balance." ***United States v. Bass***, 404 U.S. 336, 349 (1971); ***see also Gregory v. Ashcroft***, 501 U.S. 452, 460-61 (1991).

No such "change[] [in] the federal-state balance" is at issue in this case. The National Bank Act did resolve one of the major federal-state economic issues of the nineteenth century (whether there would be national banks), but the national banks it created were from the start "instrumentalit[ies] of the Federal government, created for a public purpose, and as such necessarily subject to the paramount authority of the United States." *Marquette*, 439 U.S. at 308 (*quoting Davis v. Elmira Savings Bank*, 161 U.S. 275, 283 (1896)). In section 85, Congress acted primarily to protect these federal instrumentalities by giving them the rights of the "most favored lender" in their home states. That choice of home-state law to measure the federal rights of new federal instrumentalities did not deprive borrowers' states of any power they had ever had. That, no doubt, is why in *Marquette*, where the Court held that section 85 pre-empted the core of the borrower's state's usury law, the Court did not even mention any presumption to the contrary. ***See also Barnett Bank, supra***, slip op. at 6 (Court has historically "interpret[ed] grants of both enumerated and incidental 'powers' to national banks as grants of authority not normally limited by, but ordinarily pre-empting, state law"; state law pre-empted in absence of " 'indication' that Congress intended to subject that power to local restriction"; no mention of presumption against pre-emption).

Finally, Citibank wholeheartedly agrees with petitioner that "federalism counts in section 85." Section 85 makes brilliant use of a federal system to promote a national economy. Although the Civil War Congresses were not noted for their concern for states' rights, the 1864 Congress was wise enough to reject proposals for uniform national regulation of interest charged by national banks,

and to adopt instead a system that incorporates the laws of the home states of the national banks and thus reflects and adjusts to local economic conditions, permitting interstate competition that benefits both consumers and the national economy.

As the Court recognized in *Marquette*, the debates that led to this conclusion "occurred in the context of a developed interstate loan market," 439 U.S. at 317. Congress understood that borrowers could borrow across state lines if more attractive terms were available elsewhere, and designed section 85 to fit (and foster) an economy in which they would do so, so that capital could readily move across state lines.

Congress did this quite deliberately, as evidenced by the debate in the House of Representatives as to whether section 85 should prescribe a uniform rate of interest for national banks[50] or allow states to establish the lending rates for those banks "whether the established rate be fixed with or without contract." *See* Cong. Globe 38th Cong., 1st Sess. 1353 (1864) (remarks of Rep. Price). The congressmen in favor of establishing a uniform rate of interest sought to take the management of lending charges away from the states.[51] Those opposed to the uniform rate, including Representatives Cole and Higby and Senator Conness of California, primarily represented Western states that, to attract capital, allowed borrowers to agree to any interest they found acceptable.[52] Ultimately, Congress elected not to establish a uniform rate but instead to allow each state to set those rates for banks located within its borders. In this respect, this is not a traditional pre-emption case, because within the federally defined rubric of "interest" Congress has not imposed a federal rate of interest, but instead has simply chosen one state's law of the "interest allowed" over that of another state.

The result of section 85, together with developments that have made the mechanics of lending more efficient, has been an enormous success. As the Federal Reserve Board has reported to Congress, thousands of lenders now compete nationwide to offer Mastercard, Visa, and other bank credit cards, and their competition is "intense." FRB Report 6 & n.8. These lenders compete, as the Board has noted, by offering different packages of terms. FRB Report 6 n.8, 7-8. This means that different borrowers can find packages that suit them. In particular, the ability of some lenders to offer packages that include late-payment charges means that borrowers who use their credit cards for borrowing and regularly pay on time can reduce their finance charges (because the costs that late payers impose on the lender can be collected instead from late payers) and borrowers with weak credit histories can get credit that would not otherwise be available. Robert E. Litan, *The Economics of Credit Cards*, at 7-8 (Jan. 1993).

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[50] As it was originally presented to the 38th Congress, section 30 of the National Bank Act of 1864 provided "[t]hat every association may take, receive, reserve, and charge on any loan or discount made, or upon any note, bill of exchange, or other evidence of debt, interest at the rate of seven per centum per annum." H.R. 333, 38th Cong., 1st Sess. (1864).

[51] *See, e.g.*, Cong. Globe, 38th Cong., 1st Sess. 1353 (1864) (remarks of Rep. Stevens); *id.* (remarks of Rep. Kellogg); *id.* at 1376 (remarks of Rep. Kasson); *id.* at 2123 (remarks of Sen. Pomeroy).

[52] *See* Cong. Globe, 38th Cong., 1st Sess. 1353 (1864) (remarks of Rep. Kellogg) ("I am aware of the plea that is made use of in some portions of the Western States, that we must permit high rates of interest in order to draw capital into the country."); *id.* at 1376 ("'Why is it that we of the West to-day find capital concentrated in New York? Because capital goes where it can be best placed. . . . You cannot get a uniformity of system from the complex systems existing to-day under the various laws of the several states."); *id.* at 1352-53 ("It is well known to all gentlemen here that interest varies in different localities. . . . It is frequently an advantage for persons to pay [24 percent] and even a higher rate of interest. The persons who propose to borrow money are probably as competent to judge of the advantage it will be to them as the community in general.") (remarks of Rep. Cole); *id.* at 1374 (1864) (remarks of Rep. Higby); *id.* at 2124 (remarks of Sen. Conness).

The ultimate result is that credit cards are now involved in an estimated two-thirds of all United States retail transactions. *Id.* This case, like *Marquette*, must of course be decided as a matter of statutory construction, not economic policy, but it is appropriate to note that the result of the balkanization petitioner seeks—essentially the erection of a protective barrier against interstate competition in lending by national banks—would be inefficient, costly, and highly disruptive of a smoothly functioning and competitive system of credit.

CONCLUSION

The decision of the California Supreme Court should be affirmed.

Respectfully submitted,

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APPENDICES

APPENDIX A

STATUTORY PROVISIONS

12 U.S.C. § 85. Rate of interest on loans, discounts and purchases

Any association may take, receive, reverse, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidences of debt, interest at the rate allowed by the laws of the State, Territory, or District where the bank is located, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater, and no more, except that where by the laws of any State a different rate is limited for banks organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under title 62 of the Reviewed Statutes. When no rate is fixed by the laws of the State, or Territory, or District, the bank may take, receive, reserve, or charge a rate not exceeding 7 per centum, or 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may b the greater, and such interest may be taken in advance, reckoning the day for which the note, bill, or other evidence of debt has to run. The maximum amount of interest or discount to be charged at a branch of an association located outside of the States of the United States and the District of Columbia shall be at the rate allowed by the laws of the country, territory, dependency, province, dominion, insular possession, or other political subdivision where the branch is located. And the purchase, discount, or sale of a bona fide bill of exchange, payable at another place than the place of such purchase, discount, or sale, at not more than the current rate of exchange for sight drafts in addition to the interest, shall not be considered as taking or receiving a greater rate of interest.

APPENDIX B

[Nov. 24, 1980]

Mr. David Rosenberg
Deputy Attorney General
Commonwealth of Pennsylvania
Bureau of Consumer Protection
333 Market Street, 19th Floor
Harrisburg, Pennsylvania 17101

Dear Mr. Rosenberg:

This is in response to your letter of September 9, 1980, which asks for a legal opinion regarding charges a national bank may make in relation to its credit card operations when dealing with customers who are Pennsylvania residents. Specifically, you ask whether a national bank may charge its Pennsylvania credit card customers "annual fees for the privilege of using a . . . credit card," notwithstanding the prohibition of such charges in Pennsylvania's Goods and Services Installment Sales Act ("Act"), 69 P.5. §§ 1101-2303. I have given the question serious consideration and have concluded that while the Act's prohibition probably should apply to national banks "located" (*See* 12 U.S.C. § 22 (Second)) in Pennsylvania which have issued credit cards to Pennsylvania residents, there are serious objections to applying the prohibition to national banks "located" in other states which have issued credit cards to Pennsylvania residents.

The Act provides a comprehensive scheme for the regulation of retail installment sales and revolving retail installment accounts. The Act's jurisdictional sweep is wide; it purports to apply to any "retail installment contract, contract, retail installment account, installment account, or revolving account" established by a Pennsylvania resident regardless of where the transaction originated or was consummated, so long as either an offer, acceptance, or invitation for an offer takes place within Pennsylvania.

69 P.S. § 1103. The Act, *inter alia*, regulates all charges that can be made in connection with installment sales or installment accounts. Such charges are referred to throughout the Act as either "service charges" or the "time price differential," which are defined as follows:

> "Time price differential" or "service charge" means the amount however denominated or expressed which the retail buyer contracts to pay or pays for the privilege of purchasing goods or services to be paid for by the buyer in installments; it does not include the amounts, if any, charged for insurance premiums, delinquency charges, attorney's fees; court costs, collection expenses or official fees. Wherever either of such terms is required to be used under the provisions of this act the other may be used interchangeably.

69. P.S. § 1201(10).

The "service charges" which may permissibly be charged by the issuer of a credit cards are:

> (a) On the outstanding balance, one and one-quarter percent (1¼%) per month.
>
> (b) A minimum service charge of seventy cents . . . per month may be made for each month if the service charge so computed is less than that amount; such minimum service charge may be imposed for a minimum period of six months . . . .

69 P.S. § 1904. *See also*, *id.* at § 1501 (charges on installment sales). Under § 906 of the Act, the above-quoted "service charges" are established as the upper limit of what may be charged: "The service charge shall include all charges incident to investigating the making of the retail installment account. No fee, expense, delinquency, collection or other charge whatsoever shall be taken, received, reserved or contracted by the seller or holder of a retail installment account. . . ." 69 P.S. § 1906.

The "service charge" fixed by the Act for retail installment accounts supersedes the rate of interest fixed by Pennsyl-

vania's Banking Code for "revolving credit plans," which is 12%. 7 P.S. § 309(a). *See, Acker v. Provident National Bank*, 512 F. 2d 729 (3d Cir. 1975). Your question, to repeat, is whether the limitation on "service charges" set forth in 69 P.S. §§ 1904 and 1906 are applicable to national banks with credit card customers who are residents of Pennsylvania.

Generally, the rates which national banks may charge on loans are governed by 12 U.S.C. § 85. Under that section, a national bank is permitted to charge interest "at the rate allowed by the law of the State . . . where the bank is located. . . ." In *Marquette National Bank v. First of Omaha Corp.*, 439 U.S. 299 (1978), the Supreme Court interpreted the above-quoted language to mean that "a national bank [is] located for purposes of [§ 85] in the state named in its organization certificate" under 12 U.S.C. § 22 (Second). *Id.* at 310. As construed by *Marquette*, therefore, § 85 is a choice-of-law provision under which the amount to be charged on a national bank loan is governed by the law of the state where the bank is located, regardless of the "contacts" which the loan has with any other state and irrespective of the statutory provisions of another state.

In light of an analysis of the Act's provisions in the context of § 85's language and purpose, it is my opinion that a national bank located outside of Pennsylvania is not subject to the Act's limitations on "service charges." This is because what the Act refers to as "service charges" are, in substance, interest rates for purposes of § 85. As noted previously, the Act's definitional section states that the terms "service charge" and "time price differential" are to be used interchangeably. Indeed, the Act's terminology seems to have been adopted solely as a method of escaping the ancient "time-price doctrine," under which usuary laws do not apply to credit sales. *See* Comment, *The Pennsylvania Goods and Services Installment Sales Act: One Man's Interest, Another Man's Service Charge*, 77

Dick. L. Rev. 493, 506-508 (1973). Since §§ 1904 and 1906 set forth interest rate limitations, they are inapplicable to national banks located outside of Pennsylvania.

While no court has attempted to define "interest" in the context of a statute resembling Pennsylvania's Act, there is a federal circuit court decision which points to the conclusion reached herein. In *Northway Lanes v. Hackley Union National Bank*, 464 F. 2d 855 (6th Cir. 1972), a suit under 12 U.S.C. § 86 against a national bank located in Michigan, Michigan law provided that lenders in the state could generally charge a maximum of 7% interest and prohibited such lenders from charging their loan customers more than $15 for additional expenses in connection with the loan. Savings and loan associations, however, were permitted to charge such costs to their customers. In order to reach its holding that the defendant bank could take advantage of this law under the "most favored lender" doctrine, the court, of necessity, had to characterize these "costs" as being the equivalent of interest.

Under *Northway Lanes*, therefore, all charges permitted or prohibited by state law in connection with particular types of loans may be defined as "interest." Since, as established *supra*, a national bank must look only * to the law of the state where it is located in order to determine the charges it may exact in connection with its loans, a national bank located outside of Pennsylvania need not abide by Pennsylvanias' implied prohibition of "annual fees."

Of course, if the state where the national bank is located prohibits annual fees, such prohibition would be applicable to the national bank's credit card transactions with

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* It should be noted that under 12 U.S.C. § 85, a national bank need not necessarily be governed by the provisions of state law. Section 85 provides national banks with the alternative of charging the highest rate fixed by the law of the state in which it is located, 1% above the Federal Reserve discount rate on 90-day commercial paper, or, in the case of business and agricultural * * * loans in excess of $1000, 5% above the discount rate.

Pennsylvania residents. It is interesting to note that often a state legislature, in creating interest rate "packages," will compensate for a low interest rate ceiling by allowing a lender to charge specified fees. Thus, in *Marquette, supra,* while Nebraska permitted its lenders to charge 18% on credit card loans under $1,000.00, but prohibited such lenders from charging annual fees, Minnesota, "[t]o compensate for the reduced interest," permitted banks "to charge annual fees of up to $15 for the privilege of using a bank credit card." *Marquette, supra,* 439 U.S. at 302-304. If the Act's prohibitions were to apply to out-of-state national banks, a national bank could be faced with the anomalous situation of being a "least favored lender," since it might be governed by the lower interest rate ceiling of the state where it is located but still not be permitted to levy the annual fees allowable under that state's laws. This anomalous situation could not have been intended by the authors of the National Bank Act.

As far as a national bank located in Pennsylvania, the Act, on its face, constitutes "the law[] of the state . . . where the bank is located," and would be applicable to it in the absence of a Pennsylvania statute setting a higher permissible interest rate for loans of this type made by a different class of lender. *See, e.g., United Missouri Bank of Kansas City v. Danforth,* 394 F. Supp. 774 (W. D. Mo. 1975) (national banks in Missouri not governed by that state's Retail Credit Sales Act, since they may charge higher rates under Missouri's Small Loan Company Act); 12 C.F.R. § 7.7310.

I trust this has been responsive to your inquiry.

Very truly yours,

[signed]
Richard V. Fitzgerald
Director
Legal Advisory Services Division

APPENDIX C

THE ADMINISTRATOR OF NATIONAL BANKS
Washington, D.C. 20220
[CC Logo]
Office of the
Comptroller of the Currency

February 13, 1974

Dear Mr. ——————

We have your letter of January 9, 1974, with reference to 12 U.S.C. 85.

In response to your first question, national banks may charge interest either on the basis of the limits established by state law, *or* at a rate of 1% above the discount rate on ninety-day commercial paper in effect at the district Federal Reserve Bank. Traditionally, national banks have set their interest rates in accordance with state law, but as a result of the recent rise in the discount rate an increasing number have been switching to the discount rate formula set forth in 12 U.S.C. 85. National banks may use this method of computing interest regardless of state law, and the fact that state banks may be at a competitive disadvantage is irrelevant.

Nevertheless, as your second question indicates, the notion exists that national banks may charge only what state banks may charge. This idea apparently originated with the language:

> . . . except that where by the laws of any State a different rate is limited for banks organized under State laws, the rate so limited shall be allowed for [national banking] associations organized or existing in any such State under this chapter.

The language quoted above does not limit national banks to the same rates permitted to state banks. It must be read in conjunction with the first part of the statute (ignoring, for the moment, the discount rate formula which was added in 1933). When the two parts are read

together, it becomes clearer that Congress wished to allow national banks to take interest at the general rate (i.e., the "contract rate") established by state law, but if state banks were permitted, through special statutory exceptions to the general rate, to charge a higher rate (the words "a different rate" mean "a higher rate"), then national banks shall also be allowed to charge the higher rate. Therefore, national banks are permitted to charge *at least as much* as state banks and *more* if other lenders within the state are permitted more. This is because "National banks have been National favorites." *Tiffany* v. *National Bank of Missouri,* 85 U.S. (18 Wall.) 409, 411-412, 21 L. Ed. 862 (1874), a case which recognizes the critical importance placed by Congress upon the establishment of a banking system whose principal function, initially, was to circulate a uniform national currency to replace the then-existing tender issued by state banks.

The answers to your first two questions are discussed more fully in an enclosed letter dated October 2, 1973, to a bank in your state.

In your third question, you ask whether national banks must adhere to a state law prohibiting state banks from charging interest or fees (closing fees, etc.) above a certain rate while exempting other state licensed institutions from such restrictions. Consistent with our views set out above, national banks may *charge interest* or *levy other fees* at the maximum rate permitted by state law to *any* competing state-chartered or licensed lending institution. See Interpretive Ruling 7.7310, 12 C.F.R. 7.7310, and *Northway Lanes* v. *Hackley Union Nat'l Bank,* 464 F. 2d 855 (6 Cir. 1972). In *Northway Lanes,* the court held that since savings and loan associations in Michigan were allowed by state law to charge a specified rate of interest on real estate loans, and in addition thereto "*all reasonable and necessary charges incurred in connection with the making, closing, disbursing, expending, readjusting or renewing of* [*said*] *loans* . . .", national banks in Michigan were also permitted to levy the same "reasonable and necessary charges." Therefore, state laws which limit such fees for state banks are not applicable to national banks if other state licensed lending institutions are permitted higher charges.

Your fourth question asks: When the law of the state says that the assessments on loans made by savings and loan associations shall not be deemed usury, although in excess of the legal rate of interest, is a national bank limited to "a rate not exceeding 7 percentum, or 1 percentum in excess of the discount rate on ninety-day commercial paper . . . , whichever may be the greater . . .?" The answer is in the negative. Your question is obviously brought on by the language in 12 U.S.C. 85 which states that "When no rate is fixed by the laws of the State," national banks may charge 7% or 1% in excess of the commercial paper rate. This provision has been interpreted by the Supreme Court to mean that the 7% limit is applicable only when local law forbids the taking of *any* interest, hardly a likely eventuality in any state. The effect of the court's restrictive opinion is to read the 7% limitation out of the statute. See *Daggs* v. *Phoenix Nat'l Bank,* 177 U.S. 549 (1900); Shanks, Special Usury Problems Applicable to National Banks, 87 *Banking Law Journal* 483, 486 (1970).

The curious result in *Daggs* was reaffirmed in *Hiatt* v. *San Francisco Nat'l Bank,* 361 F. 2d 504 (9 Cir. 1966). There, the plaintiff also urged that the 7% limit in 12 U.S.C. 85 was applicable to a national bank loan, and sought to distinguish *Daggs* on the ground that California law had not spoken in any manner with respect to her loan, whereas in *Daggs* the Territory of Arizona had specifically provided that the parties could contract for any rate. The Ninth Circuit found the plaintiff's argument "technically forceful" but rejected her plea on the basis of *Daggs.* Since certiorari was subsequently denied by the Supreme Court, 385 U.S. 948 (1966), it would appear that the 7% limit in 12 U.S.C. 85 can be ignored.

You also inquire whether a national bank that establishes its interest rate on the basis of 12 U.S.C. 85's discount rate formula must lower its interest rate when the discount rate falls. This question is answered in the negative, since it is our view that a rate which is legal when agreed upon remains valid throughout the term of the contract. A discussion of this subject and the exception for refinancing is contained in an enclosed letter dated November 13, 1973 to the Mississippi Bankers Association.

Finally, you ask whether under 12 U.S.C. 86 the applicable penalty is "a forfeiture of the entire interest paid or payable *plus* twice the total interest paid *or* plus twice the amount of interest paid which is in excess of the lawful rate?" We have not done any extensive research on this question and must therefore refer you to the annotations under 12 U.S.C. 86. However, on the authority of the cases listed in Note 117 thereunder, it would seem that the recovery is double the amount of all interest paid down to the time of trial, and not merely double the excess over the legal rate. At least one court has confined the recovery to double the amount of interest paid during the two year period prior to suit. *First Nat'l Bank of Birmingham v. Daniel*, 239 F. 2d 801, 805 (5 Cir. 1956).

A copy of the decision in *National Central Bank* v. *Heindel*, a summary of which is reported at CCH Federal Banking Law Reports ¶ 95,799, is enclosed. Our Litigation Section will send you a copy of the Comptroller's brief in the *Northway Lanes* case and bill you for the same pursuant to 12 C.F.R. 4.17(d).

We trust the above is responsive to your inquiry.

Very truly yours,

KENNETH W. LEAF
Chief National Bank Examiner

Enclosures
Barrett 2/10/74

APPENDIX D

[Jun. 10, 1961]

We have received your letter of June 7, 1961 in which you ask if a national bank located in West Virginia may make a service charge on a loan in addition to 6% interest, which is the maximum permitted under West Virginia law, except under the Small Loan Act.

The rate of interest which a national bank may charge on a loan is governed by Section 85 of Title 12, U.S.C., which provides that if the rate which may be charged by state banks is limited by the laws of the State, the rate so limited shall be allowed for national banks existing in such State. However, in enacting Section 85, Congress intended that, with respect to interest charges, national banks shall have the same powers as *any* competing State lending institution. Therefore, where state law permits a higher-than-ordinary rate of interest to be imposed on specified classes of loans by lending institutions, national banks may also charge the higher rate. With the foregoing exception, national banks located in your State would be limited as to the charges it may make on a loan to the same charges permitted state banks organized under the law of the State.

Very truly yours,

/s/
W. M. TAYLOR
Deputy Comptroller of the Curreny

APPENDIX E

[Jun. 1, 1956]

In a separate communication to this office accompanying report of examination of your bank completed April 25, 1956 the examiner advises us that the usual rate of interest charged by your bank on a certain type of small loans is 8% per quarter.

As you know, Section 5197 of the Revised Statutes (12 U.S.C. 85) provides, in substance, that a national bank may charge interest at the same rate allowed by state law to competing institutions. This office has ruled, in Par. 9510 of the *Digest of Opinions*, that where state law permits higher than ordinary rates of interest for certain specified classes of loans, a national bank making such loans is subject to all limitations of substance imposed by the state law which authorizes the higher rate.

Our information is that a licensee under the Small Loan Act of Oklahoma may charge 10% per annum, plus an agreed fee for expenses not to exceed 5% and in no event to exceed $15 not oftener than every six months, plus 2% per month, not to exceed $2, for certain additional expenses.

Since we are interested in any contingent liability which might accrue to your bank under Title 12 of the United States Code, Section 86, as the result of illegally excessive interest charged, we shall appreciate your advising us whether you have obtained the opinion of counsel as to whether your schedule of interest charges is within the maximum rates allowed by statute in the State of Oklahoma.

Very truly yours,

(Signed) W. M. Taylor
Deputy Comptroller of the Currency

APPENDIX F

[Feb. 24, 1955]

Reference is made to the question submitted at the recent examiners' meeting by National Bank Examiner L. Dale Shaffer, relating to charges made by some banks in Pennsylvania when the payments on installment loans are extended.

The Pennsylvania Small Loan Act, known as Act No. 70, as amended, may be found in Purdon's Pennsylvania Statutes Annotated, Title 7, section 819-1001, subparagraph A(4). The Act specifies that the permissible charge on an installment loan is a principal amount not exceeding $3,500, covering a period not exceeding three years, shall be at a rate not exceeding $6 per $100 per annum upon the original face amount of the loan for the entire period of the loan, which may be collected in advance. The Act also provides:

> ". . . No additional amount shall be charged or contracted for, directly or indirectly, on or in connection with any such installment loan, except the following: (a) Delinquency charges not to exceed five cents for each dollar of each installment more than fifteen days in arrears: Provided, That the total of delinquency charges on any such installment loan shall not exceed fifteen dollars, and only one delinquency charge shall be made on any one installment; . . ."

Under the above quoted exception in the law, state banks in Pennsylvania, and therefore national banks under the authority contained in Section 5197 of the Revised Statutes (12 U.S.C. 85) may make a delinquency charge within the permissible limits when monthly installment loan payments are extended.

Very truly yours,

(Signed) L. A. Jennings
Deputy Comptroller of the Currency

APPENDIX G

Loans; Proceeds subject to Limited Monthly Withdrawals; Interest Charged as Usurious

[Sep. 3, 1947]

This is in reply to your letter of August 14, 1947 relating to an arrangement whereby a borrower from your bank deposits the proceeds of his loan in a special account, from which he may withdraw not in excess of a specified amount monthly. You inquire whether such a plan is in violation of the laws governing national banks.

There is no legal prohibition against a national bank making a loan in periodic instalments instead of in a single lump sum, although the latter is the usual practice. Likewise, it is not illegal to accomplish the same end by placing the entire amount of a loan in a special account out of which the borrower may make limited periodic withdrawals.

However, under the latter arrangement the bank must be careful that the total charges imposed upon the borrower (whether such charges are described as "interest", "service charges", or otherwise) do not exceed the legal rate of interest. As you know, section 5197 of the Revised Statutes (12 U.S. Code 85) limits the interest charges of national banks to the rate "allowed by the laws of the State * * * where the bank is located, * * * except that where by the laws of any State a different rate is limited for banks organized under State laws", national banks located in that State may also charge such higher rate.

The courts have held that if a borrower is required to leave part of the proceeds of a loan on deposit with the lender, the transaction is usurious if the interest paid amounts to more than the legal interest on the sum *actually available* for use by the borrower. *Planters' National Bank of Virginia v. Wysong & Miles Co.* (1919) 177 N.C. 380, 99 S.E. 199; Annotation, 12 A.L.R. 1422. The law of Maryland fixes 6% per annum as the maximum lawful rate (2 Anno. Code Md. (1939) Art. 49, sec. 1). Accordingly, it would be usurious to "lend" $600 for one year on condition that the borrower leave $300 on deposit with the lending bank throughout the year, and to charge 6% on the entire $600 (i.e., $36 interest). Since the borrower only has the use of $300 for one year, a charge of $36 is actually at the effective rate of 12% per annum, which is usurious.

The situation is similar where a loan on $600 is made for one year and placed in a special deposit which is available to the borrower in instalments of $50 each month, the entire $600 being repayable at the end of the year. In this case also the borrower has the use of an average sum of $300 for one year, and the interest rate may not lawfully exceed 6% on such sum actually available to him, rather than on the full amount of the nominal loan of $600, which he would have the use of only in the last one of the twelve months.

In view of the foregoing, the bank should make certain that the total charges exacted on loans of the type described shall not exceed the maximum lawful rate of 6% on the average amount actually in the hands of the borrower during the life of the loan. Assuming that there is no violation of law in this respect, we see no objection to your bank's handling loans in the manner outlined in your letter.

Very truly yours,

(Signed) R. B. McCandless
Deputy Comptroller

APPENDIX H

[Feb. 4, 1946]

Reference is made to the request for a ruling in the confidential section of the current report of examination of the ———, with respect to the bank's system of charges on small installment loans, and the question of whether those charges may be in excess of the limits prescribed in recent Pennsylvania legislation. You advise the charges include a "setup charge" of $3 per loan, a collection charge of 10¢ per installment, and 6% interest on the original amount financed. Thus, in financing a 12-month loan of $50, the charges added would be $7.20. You state the matter was discussed with the cashier, and it was sugested that he should consult his attorney.

In view of the provisions of Section 5197 of the Revised Statutes (U.S.C. title 12, sec. 85) it is clear that if the interest charged by a national bank is in excess of the amount allowed by State law to be charged by State lending agencies which compete with national banks, it would be regarded as usurious. The attached photostatic copy of a letter dated July 6, 1945, directed to all State banking institutions by the Secretary of Banking of Pennsylvania together with the bulletin containing the text of the new Pennsylvania Small Loan Act for banks, effective April 6, 1945, and the explanatory comments contained therein, indicates to us that under this interpretation of the State law by the State banking authorities the charges exacted by the ———, in the example given by you, would be considered usurious. You should advise the bank to this effect and suggest they obtain a copy of the letter of July 6, 1945 with attached bulletin for the consideration of their attorney. The bank's attorney should also give consideration to the comments contained in the cases of *Kelter v. American Bankers' Finance Co.*, (Pa. 1932) 160 Atl. 127, and *Dickey v. Bank of Clarksdale*, (Miss. 1938) 184 So. 314.

Very truly yours,

(Signed) J.L. Robertson
Deputy Comptroller.